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# ROYAL COMMISSION

ON

# TRANSPORTATION

HEARINGS

HELD AT

**OTTAWA** 

VOLUME No.:

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17 Oct. 1960

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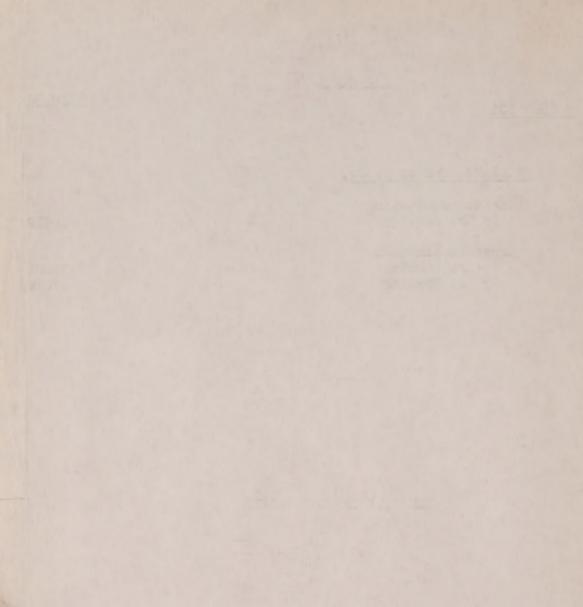
# WILLIAMS, Ernest W. Jr.

Direct examination
By Mr. Frawley

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Cross-examination
By Mr. Cumming
By Mr. Brazier

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### ROYAL COMMISSION ON TRANSPORTATION

Proceedings of hearings held in the Court Room, Board of Transport Commissioners Offices, Ottawa, Ontario, on the 17th day of October, 1960.

COMMISSION

Mr. H.

Mr. M. A. MacPherson, Q.C.

Anscomb

Mr. A. H. Balch

Mr. R. Gobeil

Mr. H. A. Mann

Mr. A. Platt

COMMISSION COUNSEL

Mr. A. G. Cooper, Q.C.

Mr. G. S. Cumming

Mr. H.W. Ellicott

Major N. Lafrance

Mr. F. W. Anderson

Adviser

Secretary

Chairman

Member

Member

Member

Member

Member

Assistant Secretary





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--- On commencing at 10:00 a.m.

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Ottawa. Ontario. Monday, October 17, 1960.

THE CHAIRMAN: Order, please.

MR. FRAWLEY: Yes.

MR. FRAWLEY: I will call Dr. Ernest W. Williams. Jr., of New York.

THE CHAIRMAN: Before we proceed, I understand you have filed a submission this morning, Mr. Frawley?

THE CHAIRMAN: In case Mr. Sinclair and Mr. McDonald have not had theirs yet, I wish Mr. Cooper would make available to them the copy we have.

You have not got it, have you, Mr. Sinclair? MR. SINCLAIR: No, I have not got ours yet. MR. FRAWLEY: I want it quite understood, if I may say a word about that --

MR. SINCLAIR: We will need five or six copies, and maybe ten. I am sure my friend knows that.

MR. FRAWLEY: There is no question about that. I would like it understood that to comply with the Commission's direction a copy was put in the mail to Mr. Sinclair. There are three memorandum. One copy was sent to Mr. McDonald, Montreal; one copy to Mr. Anderson in Montreal; two copies to me here, and one to Mr. Mauro in Winnipeg. In view of the fact Mr. Mauro is here now, I have given him one of my two copies.

As to the balance, Mr. Banks told me that in





view of the fact he had been up with his staff until 3 o'clock in the morning this last week, the main stock of the briefs will not go out until today, Monday, of this week. But it could conceivably be Tuesday, Mr. Chairman, but the Commission's direction has been complied with and they will certainly be up.

MR. SINCLAIR: I am afraid if ours has been mailed in that way it has not got through to us, and I was talking to my office this morning and it was not there.

MR. FRAWLEY: It should have received exactly the same treatment as ours, having been received in Ottawa at 10 o'clock the evening of the 15th, and it went through customs on the 17th and was delivered to me this morning.

MR. SINCLAIR: Was there pre-customs clearance?

MR. FRAWLEY: Duty- free customs, marked the 17th,
this morning. The Post Office said that they had no
alternative but to have customsclearance.

MR. SINCLAIR: This means, in Montreal, another day, because there is no pre-customs clearance.

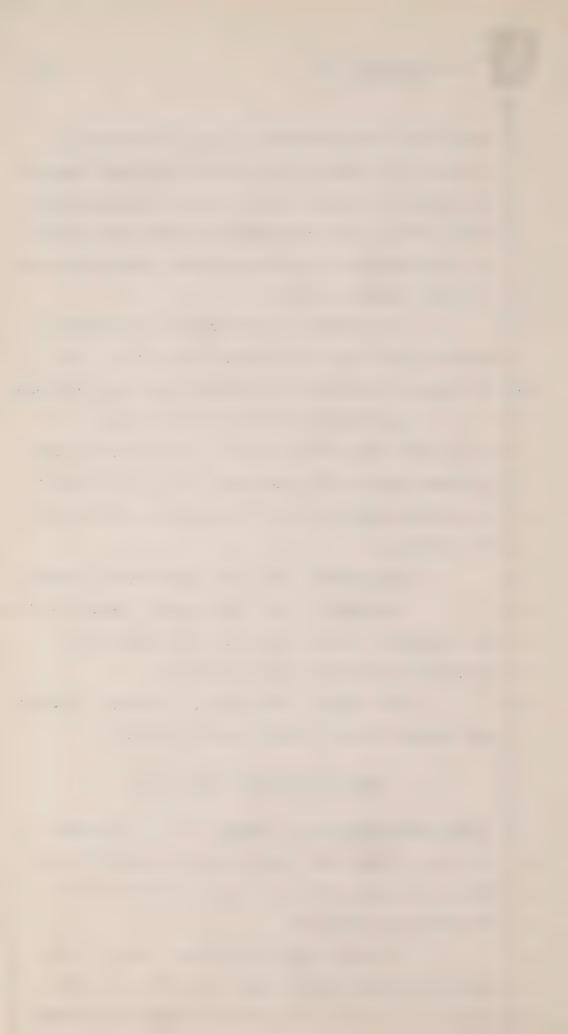
# ERNEST W. WILLIAMS, JR., called

DIRECT EXAMINATION BY MR. FRAWLEY: Q. Dr. Williams, I will read through this memorandum of your qualifications and you will agree with it or disagree with it after I have finished reading it.

You hold a Bachelor of Science degree, 1938;

Master of Science degree, 1939; Ph.D., 1951; all from

Columbia University. You have been teaching at Columbia



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member of the New York-New Jersey Metropolitan Rapid 30

since 1947, attaining rank of Associate Professor in 1952 and Professor in 1958.

The books you have written are: With Marvin L. Fair, Economics of Transportation, Harpers, 1950, revised edition 1959; The Regulation of Rail-Motor Rate Competition, Harpers, 1958; Freight Transportation in the Soviet Union: A Comparison with the United States, National Bureau of Economic Research, 1959.

You entered the government service in 1940 with the National Resources Planning Board and served as general editor and a contributor to its report Transportation and National Policy, published in 1942.

During the war you served in the Program Bureau,

U.S. War Production Board, and later as Chief. Transportation Division, U.S. Strategic Bombing Survey. After the war you went with the U.S. Bureau of the Budget with the title, fiscal analyst. Since going to Columbia, you have continued as a consultant with various government agencies. You served with the task force on regulatory agencies in the First Hoover Commission of 1948 and prepared the report on the Interstate Commerce Commission. You served in 1954-55 as a member of the task force for the President's Advisory Committee on Transportation Policy and Organization, popularly known as the Weeks Committee. In 1959 you served as director of the Commerce Department study of transportation policy. In between you were a consultant to the Office of Civil and Defence Mobilization. From 1956 to 1958, you were a



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Transit Commission by appointment of Governor Harriman.

You have testified before the Board of Transport Commissioners in the Rate Base-Rate of Return and the Rate Equalisation proceedings. Also before the Circuit Court of Cook County, Illinois, in a case involving navigation in the Port of Chicago and before the Joint Committee in the Economic Report of the United States Congress. In February of this year you were elected a director of ACF Industries, Inc.

- A. That is correct.
- Q. Now, Dr. Williams, you were asked by the provinces of Manitoba and Alberta to give some thought to the preparation of a submission which would discuss for this Royal Commission the railroad problem in Canada?
  - A. That is so.
- Q. And you did accept that commitment and you have prepared a memorandum which you have with you at the moment and which has been filed with the Commission?
  - A. Yes.
- Q. I would ask you, Dr. Williams, to proceed to put that submission into the record in the fashion in which you think best, and you are privileged and entitled to read it and read all of it, omitting only such parts, if any, as you think might be omitted.
- Q. I should like to read it in full and to make a few interpolations at several points as I go along, since upon seeing it in finished form it seems quite possible that one or two things would well merit a little bit of expansion.



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The submission as appears on its face is entitled ' he Railroad Problem with Special Reference to Competition of Non-Rail Carriers and the Resulting Distortion of the Rate Structure".

Its first head is "Similarity of Railroad Problems".

The structure of railroad freight rates is not capable of being considered fruitfully in the abstract. Both the structure and the resulting average level of rates will have an impact upon the volume and composition of traffic, not only in the long run because of the effect upon the rate. character and location of economic development of various types, but also in the short run because of the effects upon the distribution of competitive traffic among the several types of transport. Volume of traffic in comparison with plant availability will affect the unit cost of operation, thus volume and average level of rates together will be major determinants of railway net revenue. Hence, the search for an equitable and effective freight rate structure unavoidably seems to lead into a broad examination of railroad transportation, not merely, but of the character, capabilities and growth of competitive transport as well. And as all forms are affected by a variety of public policies, not only the regulatory standards for the government of rail rates are significant within the area of public policy considerations, but those which affect the supply of publicly provided facilities may also be relevant.





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It would serve little purpose for a witness familiar b, study and experience with the United States transportation scene to come before this Commission unless it appeared that transportation problems in Canada were sufficiently similar to permit applicable conclusions to be drawn out of United States experience. For such a witness, despite efforts to inform himself. cannot profess an intimate knowledge of Canadian conditions. There does appear, however, to be a close relationship between Canadian and United States transportation development. Transportation conditions in the two countries are perhaps more similar than those of any other two. Many of the geographic features evident in the northern United States extend into the more developed portions of Canada while even many of the political factors which have a bearing upon transportation policy have or have had counterparts in the United States. On a broader scale, the major trends and

problems of the railroad industry appear to be almost world-wide in character. The European literature is full of discussion of the problems of rate making in a competitive era and the tendency of European thought is not greatly different from that of much recent writing in the United States. The VIII Pan American Congress held in Washington was marked by a series of papers on economic conditions of railways in many of the countries of Latin America, which suggested that they, too, were suffering from problems of like kind with those of the United States, although often of lesser degree. Doubtless



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everywhere account for the considerable interest
expressed abroad in recent United States government
studies of transportation.

Most countries of the world which have a well
developed railroad system of long standing today face

developed railroad system of long standing today face the problem of readjusting the structure of rates, services and physical plant to the conditions presented as a result of the development of newer forms of transport. Everywhere this has been or is becoming painful. Canada would appear to be no exception. At the same time, its problems would appear to be most closely akin to those of the United States because of the parallels in the railway development of our two countries. Since the railways of Canada have not yet been presented with quite so pressing a growth of competitive transport as those of the United States, a larger opportunity should be present in Canada than is now to be found in the United States to shape the development constructively in the light of National interests. A continuance of rapid economic growth should assist to this end. I would hope, therefore, that this Commission would examine sufficiently in depth to do more than merely to treat symptoms. Particularly, since Canada has traditionally suffered from an overbuilding of transport plant, it is to be hoped that its policies in the future will seek to moderate rather than to exacerbate this significant problem. For in an economy which seeks rapid growth,





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expenditures for performance of the transportation function ought to be held to a minimum.

#### GENERAL CHARACTERISTICS OF RAILROAD PRICING

Early in its history, the railroad industry was recognized as one that operates at decreasing costs as volume of traffic increases. This is primarily a capacity phenomenon and was so recognised in many of the early writings upon the subject. To lay down a railway is to create a sizeable potential line-haul capacity -a minimum potential capacity which cannot be avoided if there is to be any railroad at all. The capacity of rolling stock, motive power and terminal facilities can be adjusted more closely to the volume of traffic actually in prospect than can the permanent way itself. It is not nearly so clear that there are economies of scale in the railroad industry if by scale we mean a multiplication of the line-haul capacity of a given segment of line. Indeed, there is much confusion in the literature upon the subject of economies of scale because of definitional difficulties.

Now, I think I might interpolate there, if I may, just a clarifying example, both of the term "capacity phenomenon" and of the term "economies of scale".

If, for example, we had a single track railroad and that railroad were loaded to 60% of its capacity, and if we had a double track railroad also loaded to 60% of its capacity, the evidence seems to



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suggest that the double track railroad working at the same percentage of capacity is not notably more economical than the single track railroad; that is to say that there do not appear to be scale differences in the cost of operation when the two railroads are loaded to a similar proportion of capacity.

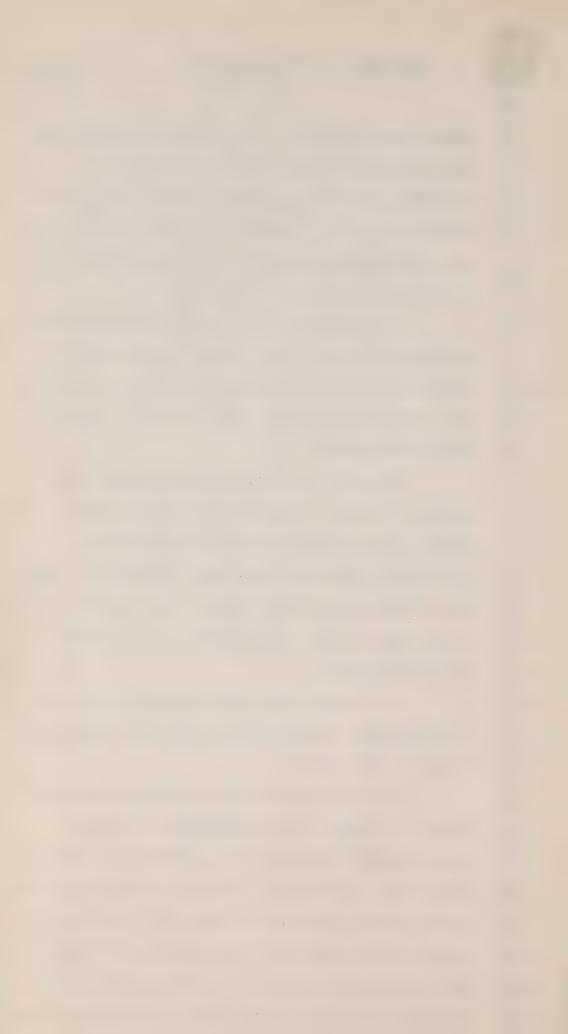
On the other hand, if we take those same two railroads and increase the utilization from 60% of capacity to 80% of capacity, then we get a reduction of unit costs in either case. That is what we refer to as capacity phenomenon.

Now, it could well be that there are some economies of scale. They are very hard to detect.

However, in comparisons of railroads of different densities and different basic plant investments -- some single track; some multiple track -- we apparently have a wide range in which the economies of scale do not disclose themselves.

On the other hand, with changes in the rate of utilization of a given plant, we do find significant changes in unit costs.

But the capacity of a line of railroad can be gradually increased by the lengthening of passing sidings and the improvement of appurtenant facilities to permit heavier trainloads, and by the multiplication of sidings and the provision of signalling to permit an increase in the number of train movements. If physical facilities are kept abreast of traffic growth, this development will, prices and other factors being constant,



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result in lower unit costs. Railroads require large volumes of traffic, therefore, in order that they may realize the full economy which is latent in the railroad technology. In this respect, they are not greatly different from other forms of transport which require the construction of a substantial improvement of the ways or routes which they use. But in highway transportation, e.g. the provision of the way that is, the highway itself, is characteristically separated from the conduct of the operation.

So that we are not accustomed to look at highway transportation in the same overall way in which we would look at the conduct of a railway operation.

This general characteristic of railway enterprises, as respects its economic structure, has everywhere led to two major lines of policy designed to improve the economic position of the carriers: 1) the construction of feeder lines to nourish main routes, and 2) discrimination in rates to encourage the development of a broader traffic base. That is, to secure the povement of low grade commodities which would not move at average rates. 'To take point one first, under most circumstances, a main route laid, across country will not generate from locations upon it a traffic commensurate with the minimum of installed capacity. Adjacent territory must be tapped and its product fed into the stream of commerce which can be made to flow over the main route. Within proper limits, system unit costs ought to decline as main routes are





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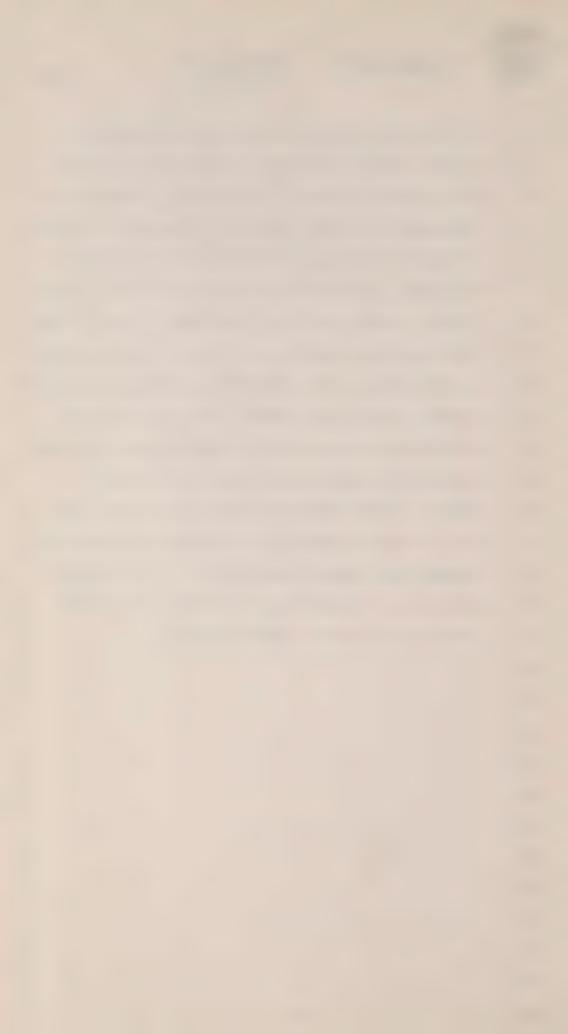
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better loaded, and both carrier and public should benefit. Particularly where competitive rail systems were developed, however, a competition in branch-line development to preempt territory tended also to develop, looking to the control of traffic to be generated in the future. Seldom was such competitive building held in check. Indeed, both in Canada and the United States. such competitive expansion was actively aided and abetted by governments. To a competitive expansion of this sort we must, in the United States, attribute much of the 60-70,000 miles of line out of 220,000 miles now judged by students of the railway problem to be excess. In Canada, it would appear that National and provincial policy tended to produce a more marked over-stimulation and that less progress has been made in tailoring the system down to required size since the close of the period of most active railroad building.



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It early appeared that rates based upon average costs of a newly developed railway, which was working well below capacity, would attract only a limited volume of traffic, generally traffic of high value capable of standing high tolls. If volume were to be achieved, which would load the plant more nearly to capacity and thus result in lower average unit costs, lower tolls must be employed to encourage the movement of commodities which were less able to bear transportation charges. Since such traffic would be added volume, it would increase the aggregate cost by less than the added volume times the previous average unit costs. Hence, lower rates could be made and, if successful in generating volume, would improve net revenue. Since kinds of traffic movement could be distinguished for rating purposes it was not necessary to reduce the existing rates upon such traffic as was capable of bearing such rates. Discrimination was in order. And it could be shown that, if the rates which were named to generate new traffic were above the added costs occasioned by such traffic and if total ' earnings were held to a reasonable level, all would benefit.

Q. I notice in the sentence you use the words "added costs occasioned by such traffic." We have been told here about out-of-pocket costs, variable costs, incremental costs, direct costs. Would you please tell us what you mean by the use of the words "added costs" as distinguished from the definitions that



I have just given you?

MR. SINCLAIR: Would you do them again?

MR. FRAWLEY: Out of pocket costs, variable costs, incremental costs and direct costs.

A. I think all of these terms are inclined to give us difficulty and that is true certainly not only of the laymen but also true of the economists as well. We sometimes get tangled up with a variety of definitions for some of these terms. I used the term "added costs" pretty much synonymously with the term "incremental costs" that you ordinarily employ. What seems to be relative at this particular point would be a comparison of the total costs of handling the expanded volume of traffic with the cost that was encountered in handling the lesser volume at an earlier point. The difference between the two is the added costs occasioned by the traffic developed.

The problem is not, however, in any sense a simple one because when we undertake to make rates we are, of course, making rates for the future which are expected to move traffic in the future. In consequence of that fact it is necessary, if such a rate is to be intelligently made to estimate what the probable volume of traffic will be to induce that rate and what the effect of that increase will be on the costs or looking to a rate made for the future and all the elements here required to be estimated.

Now, as compared with the direct, out-ofpocket cost as we have commonly to employ it in the

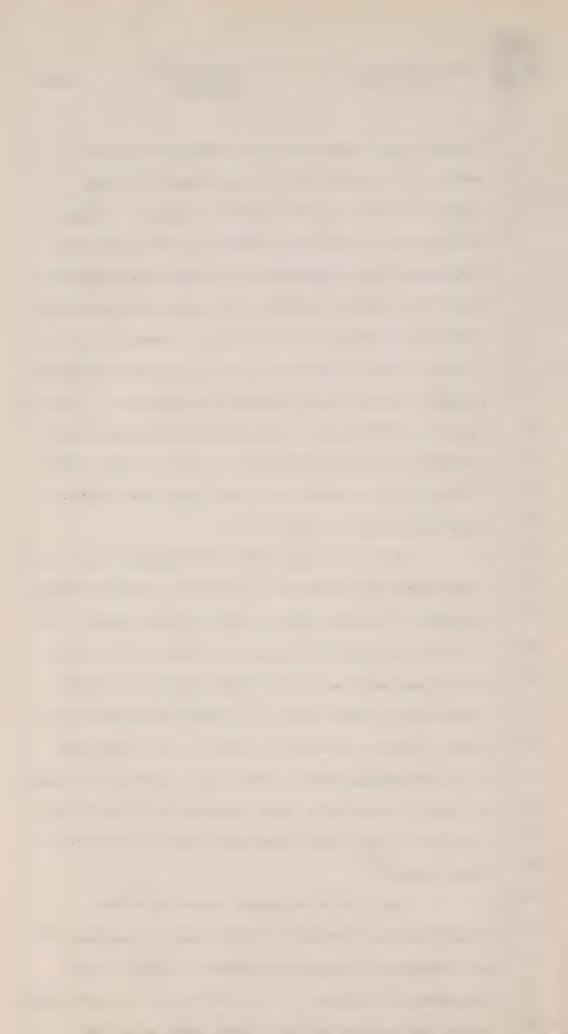


United States, when we use the term we may almost read into it what we are talking about as out-of-pocket costs developed by the ICC formula. These out-of-pocket costs have created a certain amount of controversy among economists as to what interpretation might be placed upon them and the principles which the Commission used in devising them. Essentially, No. 1, they are average territorial costs as we total them and regularly publish them through the Commission. Secondly, the representated concept that the economist might perhaps call bong-run marginal or out-of-pocket costs. I think it is not clear that they would even coincide with an economist's cost at all.

The run of time here, incidentally, is of very considerable importance as is also the amount of change in volume of traffic that we may be talking about. If we are talking about a very small increment of traffic then it may well be that the added costs or variable costs will be quite small. If we are talking about a large increment of traffic it may be quite large and if we are talking about a very large increase the volume of traffic occasioning large expansion of plant it may be that the added costs come very close to the out-of-pocket costs.

Now, the art-of-pocket costs which the

Commission has developed is essentially a long-run formula designed to cope with assurance with very large
increments of traffic. It, therefore, is a cost which
takes into account not only those costs which the



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THE WITNESS: Well, avoidable costs require that we look at the thing from the other side. Essentially what we are talking about there is the cost of a reduction in the volume of traffic or a shedding of

Commission has detected by its statistical studies to be variable costs but it takes into account also an allowance of four per cent return on the investment in 100 per cent of the motor power and rolling stock and 50 per cent of the permanent way and structures. That would put it in the category of a cost that could be related to what I referred to here as the added costs, but only if one is talking about a very large increment of traffic over a long period of time occasioning a substantial plant expansion as well as a substantial increase in the proportionate increase in the rolling stock and motive power employed. Many of those terms will tend to differentiate themselves because of differences in size of the increment of traffic that is held in the mind, or the length of time it is held in mind.

Those are perhaps the most difficult problems in handling the extending of the cost of figures.

would, of course, be those costs added by the substantial increment of traffic that was concerned with the rate change referred to.

commissioner mann: While we are on the subject of terminology, could you give us a definition of avoidable costs?



traffic, a n y section of which hopefully the costs of the handling of the remaining volume are lower than the costs of handling the volume before. The avoidable costs would be the opposite of added costs, that is, the amount of costs that did appear from the cost structure as a result of the essential change in the volume of traffic. It need not be necessarily accepted as essential change will look exactly the same as the upward changes because the problem, the shedding costs, is sometimes more difficult than the problem of controlling costs in the face of an increase in business.

COMMISSIONER PLATT: While we are on defini-

THE WITNESS: Well, the economist tends to use average costs, several types of average costs. When we speak of average total cost, for instance, this is fairly simple, it simply takes the total cost of all kinds encountered and there may be some slight disagreement among economists as to whether certain things are costs or not costs. But, leaving that, we would

take the total costs including the imputation of rolling

and equity capital and divide it into the volume of

business and we get the unit average total costs.

tions, would you mind defining average cost as well?

However, we refer on the other hand to avoidable variable costs and we are referring to the average costs per unit which are expected to vary as there are changes in the volume of traffic either upward or downward. Customarily, for the purpose of simplicity, we take the average variable costs as they have been



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ascertained at certain levels of traffic that are statistically observable and apply the other changes that may come along necessary to the relationship between forecast and outright costs to haul with the changes in the level of business that is being handled. Those are the principles that we ordinarily employ.

MR. FRAWLEY: Q. Thank you. Will you continue?

A. For the policy of discrimination would lead to lower average unit costs and ultimately to a reduction in the higher rates in order to keep earnings in check.

That probably calls for a little explanation. The direction of the unit costs as a result of the capacity phenomena, that is, if the railway plant is led by taking on additional traffic from discriminating rates, the average unit costs follow and the railroad is in fact performing a service more efficiently, it is producing more ton miles or it is producing a larger increment of ton miles than the increase of cost which is observed in connection with that. In consequence, not only has there resulted from the policy of discrimination of freight to move lower grade products at rates that are not at the average level which has implications for economic development but, secondly, because of the reductionof unit costs as a result of increasing efficiency and the use of plant, there is a reduction in unit costs that should benefit all traffic whether moving at average rates or above average rates.



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The classification of freight, therefore, became early an established practice and was increasingly embellished over the years. In addition, low-grade commodities and heavy volume movements were increasingly accommodated by commodity rates which removed them from the classification structure and, on occasion, no doubt, extended the range of discrimination practised.

I might say I use the word "discrimination",

I think in all cases, in the sense that the economist

uses the term. It is not used with a sense of undue

or unjust discrimination. There is no such meaning

at all. I am speaking of discrimination in respect

to a differentiation of rates in relation to the unit

costs.

Particularly was this true of commodity rate structures, of which there are many examples in the United States, where commercial and market competition were allowed in large measure to determine the rate relationships.

entiated the levels of rates with some regard
to differing regional conditions and as between main
and branch lines in recognition of differences in cost
levels. Public policy has generally forced upon
railways a large amount of additional discrimination,
which they would not have resorted to were they left
to govern rate making policy purely in their own
interests. Thus, mileage scales have often been



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uniformly applied over large areas, equally to light traffic branch lines where good loading of the plant cannot be secured so that average unit costs must remain high, and to heavy traffic main lines where low unit costs can be achieved. Thus, some traffic is called upon to subsidize other traffic through an averaging In the class rate adjustments of the 1920's and early 1930's the Interstate Commerce Commission generally prescribed arbitraries for application over short and weak lines and in limited territories, such as northern New England and Michigan and the Florida Peninsula. This was a response to corporate need, however, where separate companies were compelled to rely on such low-density and frequently low-grade traffic for the bulk of their revenues. Where similar conditions existed on lines operated by major systems it was considered just that main-line traffic should pick up some of the cost of branch-line operation. Further to accentuate the problems, the pressure to furnish service beyond that which traffic will support at established levels of rates has often been most severe in respect of light-traffic routes and has seldom been a matter of consequence on routes which are well enough supplied with tonnage to occasion a considerable offering of service.

The general phenomena just described were brought to a high devree of development under the philosophy of regulated common carriage in the period just before non-rail forms of transport began to



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develop and to enter into competition with the railsystem -- a philosophy which had come largely to be
shared by carriers and regulatory authorities alike.
This was described by me for the Department of Commerce
in Rationale of Federal Transportation Policy, April,
1960, as follows:

"There are a number of aspects of that philosophy which seem to have escaped general understanding. Railroads had, along with their associated express companies, become common carriers of virtually all commodities known to commerce, in the absence of any suitable substitute services until the twenties. The public had, apart from local cartage and urban transit and a few specialized bulk water carrier services, become almost wholly dependent upon the railroad system for its transportation require-It was both natural and appropriate ments. that there should be placed upon the rail carriers the obligation to serve all without discrimination and to do so at reasonable and not unjustly discriminatory rates. Both the railroads in the development of their own policies and the regulatory authorities in accepting and further embellishing those policies, treated the railroads so far as possible as unified systems within broad territories catering to the entire consist of traffic generated by the economy.



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"Under the circumstances, so long as the rate level was maintained high enough to permit the earning power needed to keep railroads abreast of the needs of the traffic, great latitude could be used in fixing rates for particular hauls and particular classes of traffic. The costs of handling particular traffic could be and were ignored in considerable degree and, under the conditions, little effort was made to ascertain the costs for particular hauls or services. Measures of operating efficiency which were independent of revenues were used to control operations. the method of comparison served to enable rates for particular traffic movements to be brought into what appeared to be an equitable relationship to the remainder of the structure of rates. Thus, the making and regulation of rates took on the characteristics of an art, and the principles which were applied were more nearly those of equity than of economics.

"Discrimination, in the economic sense of disparity of rates from the costs of the particular services rendered under the rates, was widespread and had the approval of public acceptance and regulatory precept. It was inherent in the process of classifying freight in which, although relative cost of service on the average was given weight, the supposed value of the service doubt-

less was a more significant factor. It was inherent in the extension of mileage scales of rates to more and more of the traffic- scales in which characteristically for the lower classes the short-





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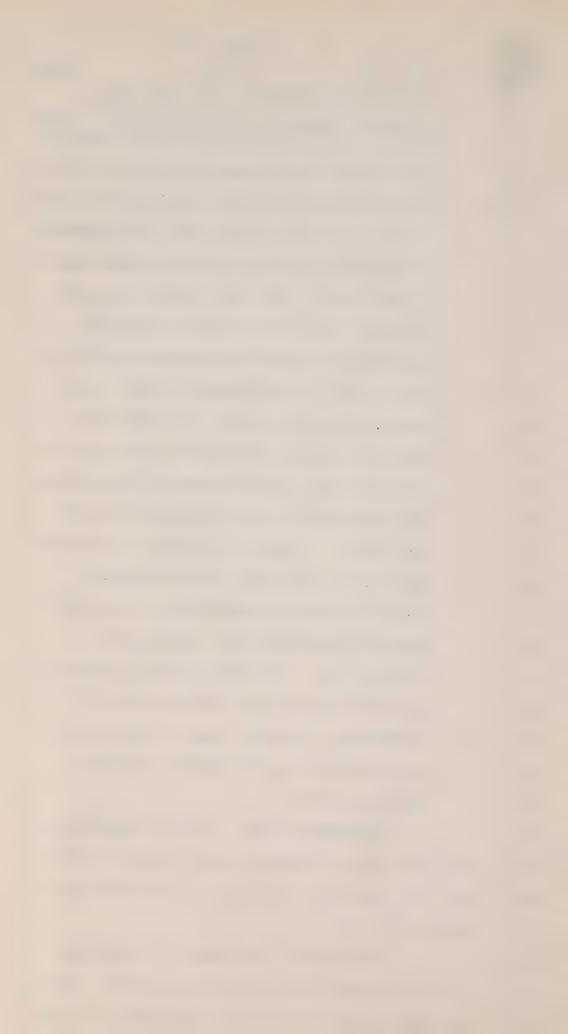
# Williams, dir (Frawley)

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haul and very long haul râtes were below cost, while the rates for middle distances on the higher classes were well above cost. It was inherent in the application of the same level of rate to light traffic branch lines as to high density main routes and in the charging of like rates for the occasional carload as for the continuous mass movements of basic commodities which moved at lower costs. The whole formed an integral system of rates made up of long-established relationships to which business had adjusted itself and upon the continuance of which it expected to be able to rely. The system was based upon internal subsidization, that is, the subsidy of some traffic movements on which rates were below cost by others on which rates were above cost. In short, the costs of supporting the railroad system were distributed upon classes of traffic, communities and particular hauls in rough accord with the supposed ability to pay. And such a system was widely believed to promote the freest movement of commodities, the widest range of competition in distribution and the maximum stimulus to economic growth."

commissioner mann: In this passage you have just quoted from when you use the terms "below cost" and "under cost" is that above and below fully distributed cost?

THE WITNESS: No, indeed. I would have in mind the added cost in the sense in which I used the term, I would not say it is a question of -- you



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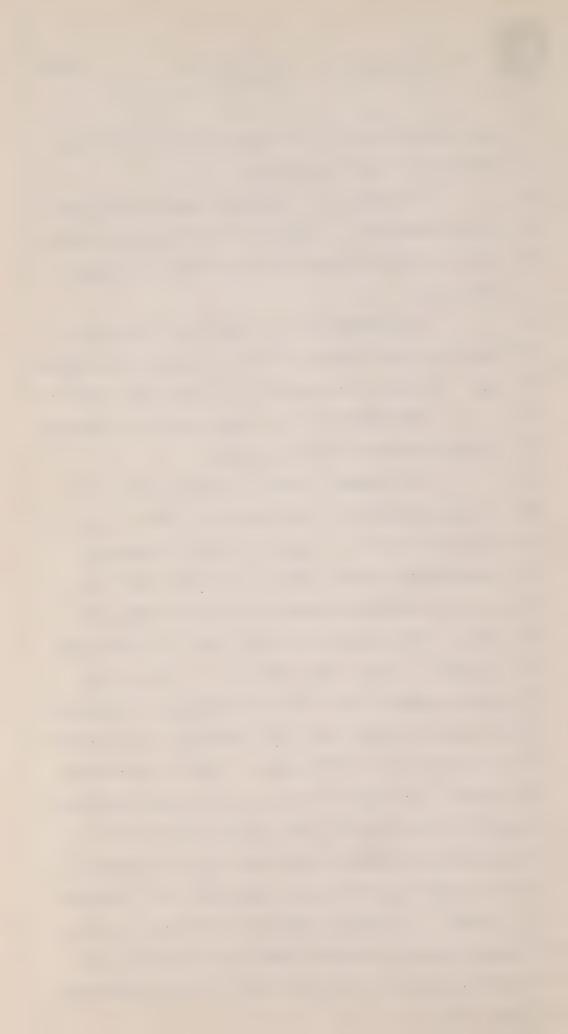
have the fixed cost, your overhead would have been distributed cost class of traffic.

MR. SINCLAIR: Does that apply in every part of the submission? Have you not changed the definition in different places or is your answer to apply to every part?

THE WITNESS: The definition of costs, oh, I dare say it does possibly differ in one place and another here. However, the meaning is as I have just stated it.

MR. SINCLAIR: Cost means added cost throughout this quotation; is that correct?

THE WITNESS: Well, not exactly added cost if one is dealing with this stratum of traffic, no. One cannot, after all, analyse a complete expanding transportation system, break it into these parts and do it for ordinary purposes on a strictly added cost basis. It would be more proper there to use the term "variable", I think, than added cost. This is an instance perhaps since we are not talking of fluctuations and traffic volume, added cost terminology is not quite as pertinent as at other points. What is meant here. however, is not what we all talk of as fully distributed costs but what we talk about as the variable costs associated with the movement since the distribution of the overhead is not the full phenomenon that I referred I might say there have been and are in the to here. United States substantial numbers of rates which move traffic which are below the variable costs of performing the service.



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Development of Competition: It will be observed that the system was depended upon a condition in which all characters of haul were embraced within a single regulated system which the public was compelled to use for virtually its entire transportation requirements. It was essential that the shipper be unable to perform any significant amount of transportation for himself. It was essential, also, that the competition of non-rail carriers be sufficiently sporadic in locational incidence so that it might be treated as an exception. In both the United States and Canada water competition via the Great Lakes and connecting channels was undoubtedly the most important exception, but so far as it was in fact competitive with railroads this transportation was capable of being brought under some degree of control and its package freight rates differentially related to the rail rates.



Both in Canada and the United States, the

necessary conditions for the effective application of

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the traditional principles of railroad rate making began to be destroyed with the development of competition by other forms of transport upon an increasing scale. In the United States, the volume of intercity truck transport was first estimated in 1926 at 5 billion ton miles compared with a total of 765.8 billion for all forms of transport. Rail traffic in that year was estimated at 64.1 per cent of total. By 1940, truck traffic had grown to 62 billion ton miles and the rail share of the total had declined to 46 per cent. In the post-war period rail traffic has fluctuated at a level between 550 and 707 billion ton miles, but appears to show a gently declining trend, since traffic at the peaks and troughs of the later cycles appears to become regularly somewhat lower than for the preceding cycle. Total volume of transportation, however, increased approximately 40 per cent from 1945 to 1956. More than this entire growth is accounted for by the growth of non-rail forms of transport. Truck transport, for example, quadrupled between 1945 and 1956. Under these circumstances the rail share of the total declined to 41 per cent in 1956 and 40 per cent in 1957, the latest year for which we have data covering all forms of transport.

I might interpolate here, that the percentages

which I show in this submission will not agree with the

percentages ordinarily published by the Association of





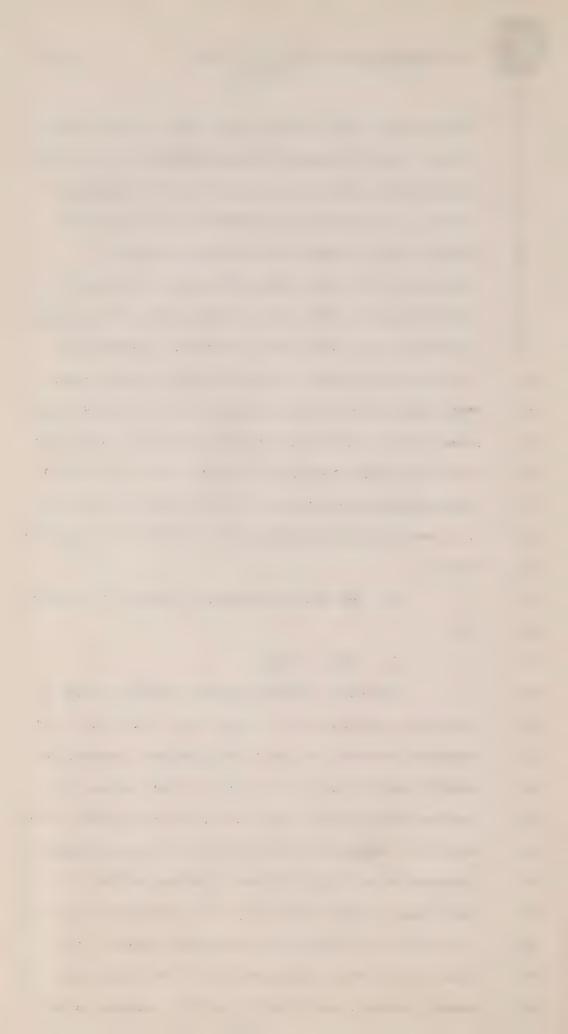
# ANGUS. STONEHOUSE & CO. LTD. Williams, dir. (Frawley)

American Railroads for the reason that I have included in the total U.S. Domestic Transportation the ton miles generated by coast-wise and intercoastal steamships service. Our estimates of that have not been very perfect, and in some years have been hitherto unavailable, but that transportation is certainly an important part of the whole picture, and it has always seemed to me it ought to be included. Consequently, the rail shares which I show here are somewhat lower than those which are published by the American Railroad Association. The result of including that volume adds some 250 billion ton miles in most years to our total transportation domestically in the United States, and, as a result, the railroad share calculates to a smaller figure.

Q. And that is shown on appendix "A" at page 42?

### A. That is right.

Estimates prepared by the Dominion Bureau of Statistics indicate that in Canada the total volume of transport measured in ton miles increased somewhat more rapidly than in the U.S. in the post-war period, the increase being of the order of 66 per cent between 1945 and 1956. During the same period truck transportation increased at a slightly slower ratethan in the United States and the rail share fell by 22 percentage points, or virtually the same as in the United States. As a result of the more rapid growth of total traffic in Canada, however, rail traffic had been trending slowly



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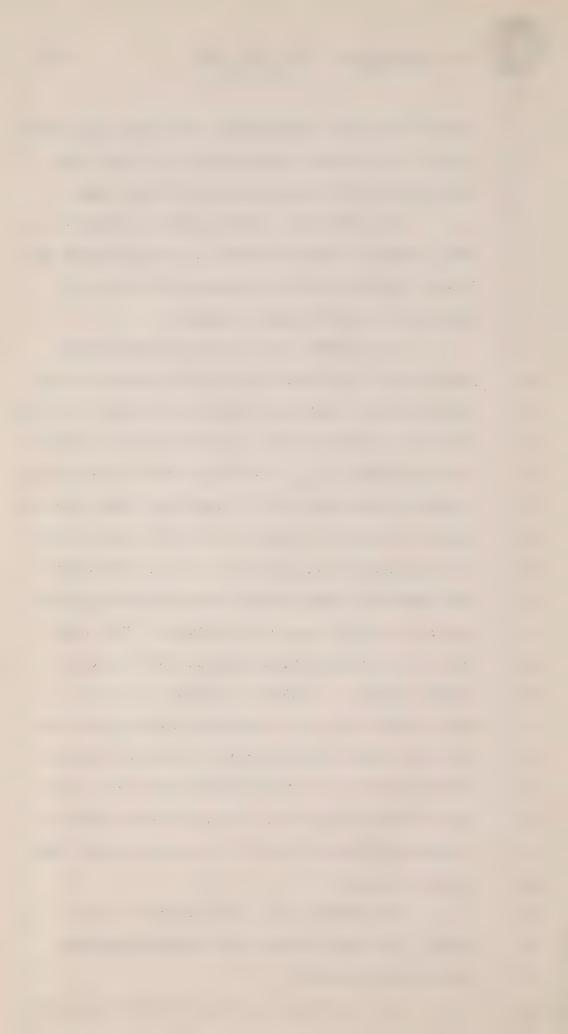
upward rather than downward until the total volume fell in 1957 and 1958 and, simultaneously, in a mere two years truck traffic increased nearly 40 per cent.

MR. SINCLAIR: Could I interrupt there to ask this, because it may save time: was an adjustment made in that calculation for the change in the basis of reporting the truck tonnage in Canada?

THE WITNESS: No. I used the quite recent publication of the Dominion Bureau of Statistics which I assumed was a consistent showing as to those ton miles. If it had an inherent shift of method of base, I fear I failed to detect it. In the United States data there is a shift in the last couple of years which makes our late figures not entirely comparable with the earlier ones, and we have been hoping to get a reconciliation from the Interstate Commerce Commission shortly which would enable us to mesh those with confidence. That sort of thing not infrequently has happened with the motor carrier series. . I take it in Canada, as in the United States, those are estimates, and we regard ours as pretty rough because we have to pick some samples through the Bureau of Public Roads checks and we have to blow that up and get the ton miles which sometimes we treat as a statistic when it is really no more than an educated guess.

MR. FRAWLEY: Q. What you say is, these figures are taken from the most recently published material of the D.B.S.?

A. So far as I am aware, that is true, yes.





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### ANGUS. STONEHOUSE & CO. LTD.: Williams, dir. TORONTO. ONTARIO (Frawley)

In the United States, truck traffic has shown only modest growth since 1956, but the recession characterizing a good part of the period precludes drawing any conclusions from this fact. It appears that Canadian railways have not yet felt the full brunt of truck competition for, in 1958, truck ton miles were but 21.2 per cent of rail ton miles whereas in the United States this percentage stood at 42.6. The Canadian rail share of total traffic is still well above the share of United States railroads.

#### Consequences of Competition

The development of competition from non-rail forms has been far more damaging than the ton-mile figures would suggest. Especially is this true of the effects of truck, products pipe line and (in the United States) certain inland waterway competition. By 1951 regulated motor carrier revenues per ton miles in the United States already exceeded 5 cents, hence it would not be unreasonable to calculate the whole of the intercity truck ton miles (including private and exempt) at 4 cents a ton mile. On this basis, truck freight revenue equivalent would have passed rail gross freight revenues in 1953. By 1957, with revenues per ton mile at a higher level, truck ton miles of 260 billion taken at 4.5 cents per ton mile would imply a revenue equivalent of \$11.7 billion compared with railroad gross freight revenues of \$9.4 billion. When looked at in revenue equivalents the significance of truck

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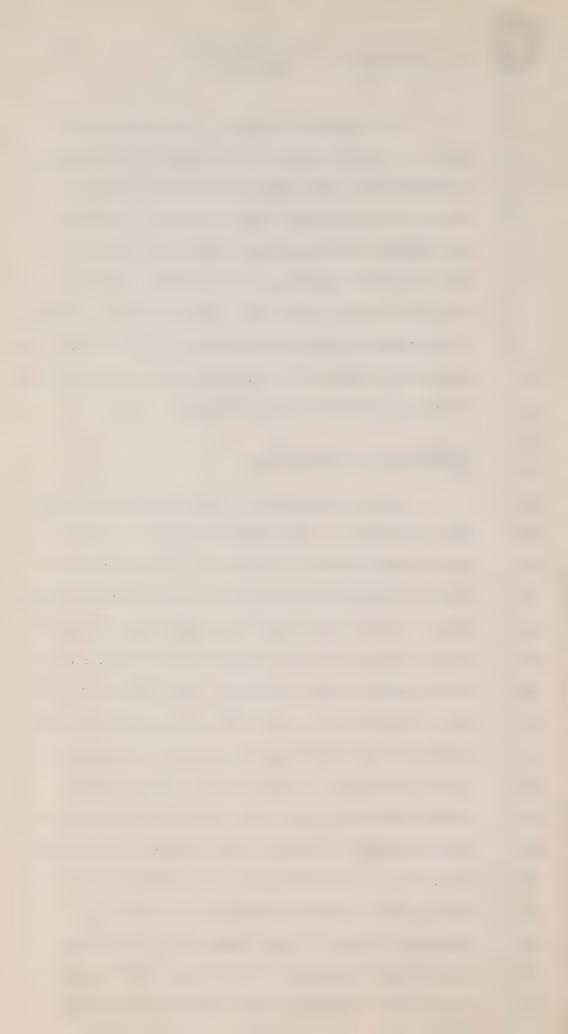
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## ANGUS. STONEHOUSE & CO. LTD. Williams, dir. (Frawley)

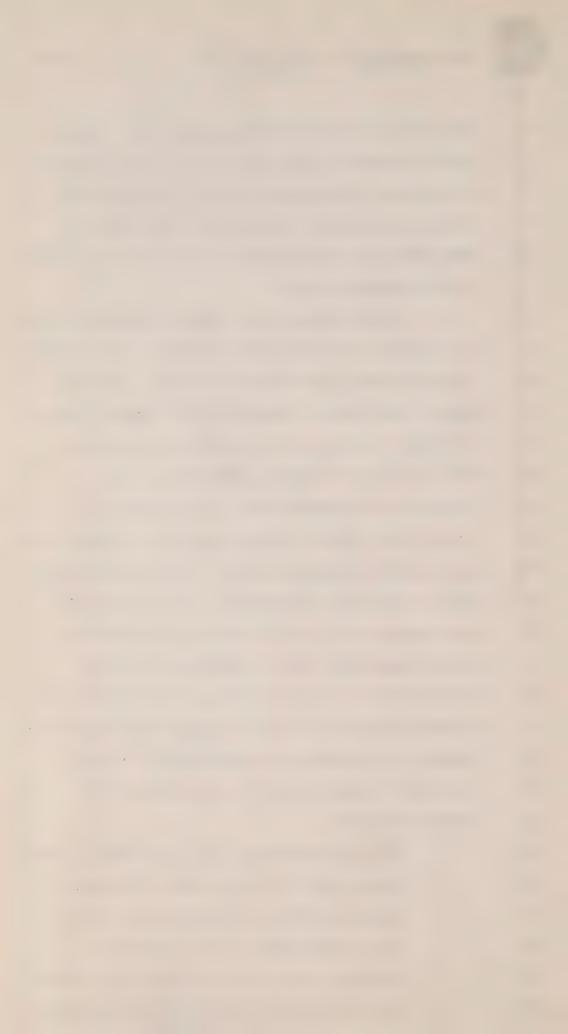
transportation is more readily appreciated. Judging from the ton-mile data reported by the Dominion Bureau of Statistics and applying revenues per ton mile at United States levels, truck revenue equivalents in Canada must have approximated 90 per cent of rail gross freight revenues in 1958.

As the revenue data suggest, competitive forms of transport do not attack the structure of rail traffic across the board, but rather in a highly selective manner. Each form of transport has a different economic structure, a different set of cost functions and a different range of service capabilities. Hence, beginning in a situation where railroads handled virtually the entire stratum of traffic, the newer forms have selected attractive portions of that stratum upon which to focus their competition. While truck and water carriers are wont to complain about selective rate cutting on the part of railroads, it is the selectivity of the service offering of the newer forms of transport that is breaking down the traditional rate structure and creating great difficulties for the railroads. To quote again from the Department of Commerce Rationale:

"The increasing availability of public rights of-way open to all who found an advantage in using them offered an oppor; tunity not only for the development of new systems of transport, but also an opportunity to whittle away at the established common-carrier system until the basis of its support became

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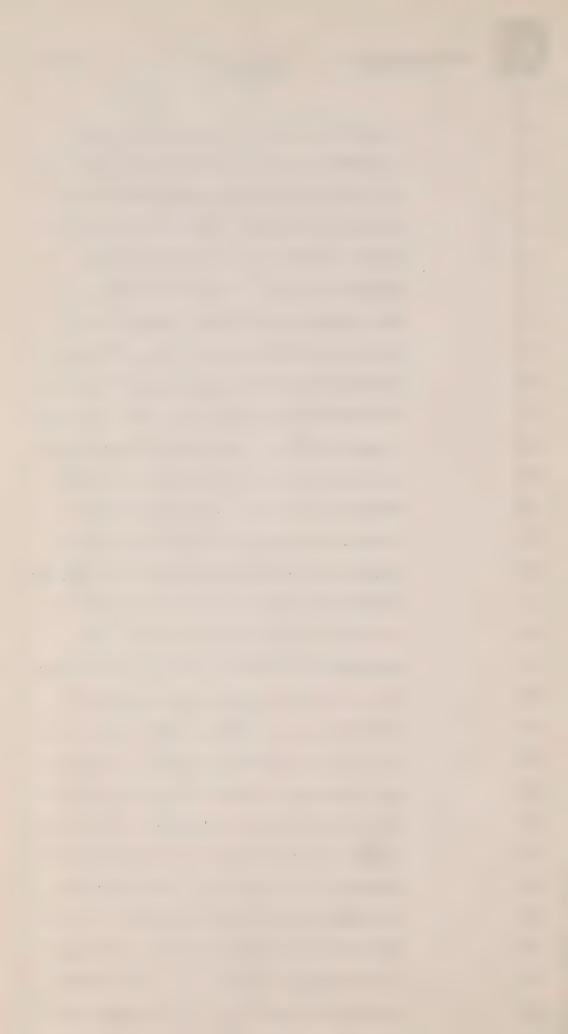
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uncertain. Had the railroad rates been adjusted even approximately to the costs of the particular servoces which were priced. the new competitors would have been able to divert traffic and participate in the expanding volume of traffic generally only when their costs were low enough to enable them to match or under-cut the rail rates or where they offered a superiority of service for which the shipper or traveller was willing to pay a premium. The course of development would have been quite different from that which occurred. But both the regulatory authorities and the railroads preferred to ignore the trends and their implications, and neither undertook to set in motion broad correctives in the rate structure. To compound the difficulty motor common carriers, faced with the problem of filing initial tariffs under the Motor Carrier Act in 1936, found that substantial adoption of the rail rate structure afforded the most practicable means of meeting the procedureal requirements as well as to develop their traffic volume by diversion from railroads. Motor carriers, of course, confined their holding out to the relatively high valued traffic only, except on the shortest hauls, for to do otherwise would have opened them to the obligation to





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carry unprofitable traffic on a considerable scale. The regulatory system, following the view generally that carriers were entitled to meet their competition but not to undercut it, was capable of placing considerable restraint upon rate competition and to preserve much of the rate structure from major alteration by the action of the regulated carriers. The maintenance of rail and motor common carrier rates upon a substantial parity, however, without reference to the relative cost of service by the two forms of transportation, undoubtedly promoted the development of motor carrier traffic at the expense of rail to the extent that it prevented the cost advantage of the railroads, where it existed, to be made manifest in the rate.

"Notwithstanding the extension of regulation to other than the rail and pipeline forms of transportation, however, substantial areas have been left unregulated. Indeed, nearly half of the intercity freight transportation, measured in ton-miles, appears today to fall in the categories which are untouched by economic regulation. Much of this transportation is private carriage by motor or by water, although substantial traffic is also moved on a for-hire basis within certain

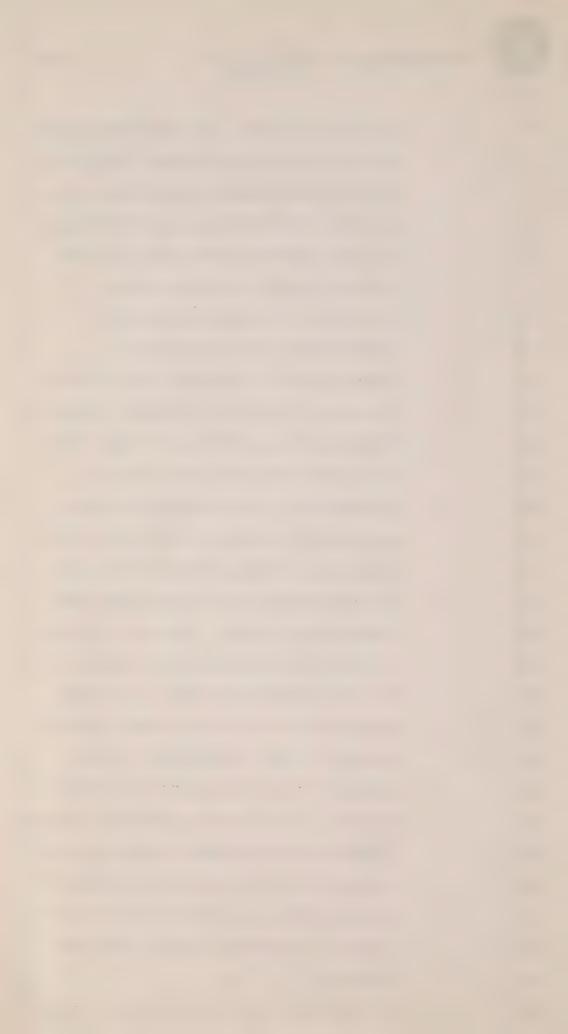




## ANGUS. STONEHOUSE & CO. LTD. Williams, dir. (Frawley)

of the exempt areas. The regulatory system affords ppor protection against the growth of private and exempt transportation. Yet the rate structure which regulated carriers and the regulatory authorities alike have south to preserve, extends an open invitation to the growth of private transportation and of specialized transportation in the exempt areas, as well as marginal and outright unlawful operations. Naturally this growth tends to occur first in the areas where the regulated rate structure lies farthest above the cost of performing the service and therefore attacks directly the traffic hitherto relied upon to achieve cross-subsidization within the common-carrier system. In short, it tends to divert the most remunerative business and to reduce significantly the base of high revenue traffic upon which common carriers can rely in order to subsidize the less remunerative and losing portions of their business. This process, already far advanced in the railroad industry is evident also in the motor and water carrier industries and may be expected to continue to grow in the absence of substantial change in the rate structure."

Q. Would you turn back to page 14: in the



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bottom paragraph you refer to exempt areas?

A. Yes.

Q. That expression may not be self evident. and I wonder if you would explain 1t?

A. We have a number of exemptions under Part II and Part III of the Interstate Commerce Act. of which I might mention the most important. Under paragraph 2 it relates to motor carriers and is. in fact, the Motor Carrier Act of 1935 as amended. The principal exemption, the one which has given most trouble to carriers, is what we know as the agricultural exemption which, in effect, exempts from economic regulation -- that is, regulation of rates as well as the control of entry through the requirement of certificates of public convenience or necessity -or permits the movement of unmanufactured agricultural products: fish or shell fish, as well as ordinary livestock. That is a thing which went through a great expansion and by interpretation of the courts as to what falls within those categories, and which we tried to at least hold within presently established limits by an amendment to the definition in the Transport Act of 1958, but the agricultural exemption is the most important under which large amounts of truck traffic move.

Under Part III of the Act, which relates to water carriers operating in coast-wise, intercoastal and inland service, there are two important bulk exemptions which result in the greater part of that



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water traffic being exempt from economic regulation. Those are what we call the liquid bulk exemption which exempts the bulk movement of petroleum and petroleum products, chemicals and the like; and secondly what we know as the dry bulk exemption which exempts the movement of dry bulk commodities such as coal or various ferrous and non-ferrous ores so long as not more than three such bulk commodities are shipped in any one vessel or tow. The consequence of that is that a very large part of our inland water transportation and almost the whole of our coastwise transportation become exempt under either the liquid bulk or dry bulk exemption.

In general, highway competition attacks remunerative hauls by railroad under a discriminating rate structure under any one or a combination of the following circumstances:

- (a) High rated traffic on which rail rates are above trucking costs for any length of haul;
- (b) A considerable range of traffic in the middle distances (say 200-400 miles) where distance scales of rates tend to lie higher in relation to the cost function than they do for shorter and longer hauls under the tapering principle, but more importantly where the rate scales lie in more profitable relationship to truck costs than at longer and shorter hauls;
- (c) Between major points on principal heavydensity routes where the level of rail rates on the averaging principle brings many of them well above cost and where, if service to intermediate points is kept to



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a minimum, exceptionally good truck load factors can be secured.

Point (b) is illustrated by Appendix B who

Point (b) is illustrated by Appendix B where the Docket 28300 scale of class rates prescribed for use within the United States is contrasted with I.C.C. carload cost scales for the Eastern district on 10-ton carloads, a size of consignment directly competitive with truck transportation. It will be observed that class 100 rates exceed three times the fully distributed costs. Yet class 30 rates are at out-of-pocket costs for a 10mile haul, are slighly above fully distributed costs at 50 niles and lie above those costs to, and including, 400 miles. At 1000 miles, however, they fall below out-of-pocket costs. This is illustrative of a condition to be found in most distance scales constructed upon conventional principles. The relationship of the rate scale to the costs will alter over time. Particularly is this true where percentage increases are employed in the rates while a combination of wage increases and technological change produces a greater increase in terminal and way-freigh costs than in the line-haul costs of through train service. This phenomenon has been characteristic of the post-war inflationary period. It tends to produce the effect, in addition to those noted above, of making the railroad attractive in lieu of truck for short-haul movements which, on the lower classes, must be handled at a loss by rail and could often be handled at lower costs by trucks. To the extent these loss areas are expanded, a



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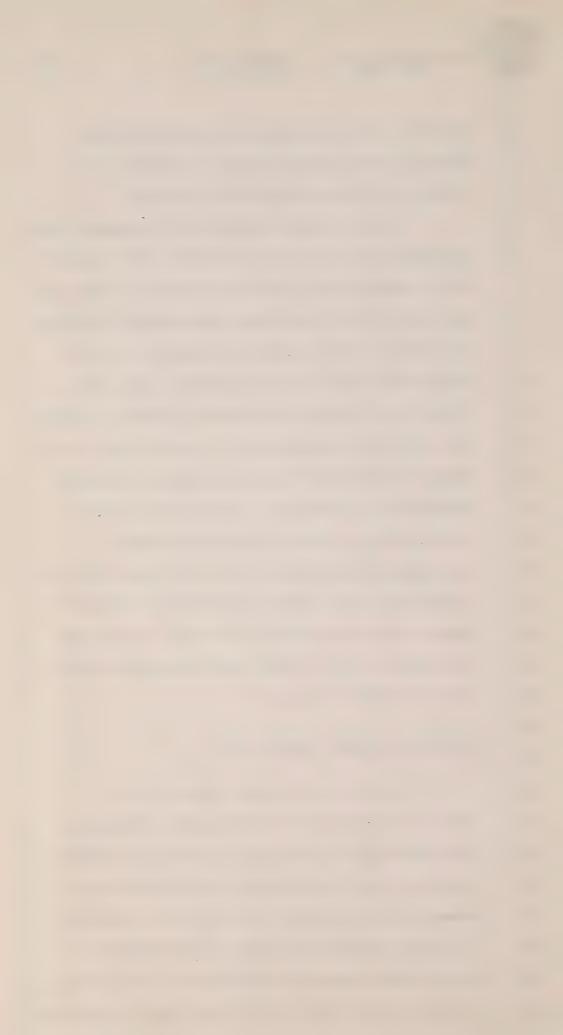
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burden is cast upon longer-haul traffic and the measure of the percentageincrease required on any standard of revenue requirement is raised.

Thus, a general-purpose rail transport system equipped with a rate structure built in the light of such a comprehensive offering of service is faced with quite specialized competition which attacks the highyield traffic while leaving the low-yield traffic undistrubed. Under such circumstances, the whole principle of internal subsidization commences to break down. Further complications will appear where, as in Canada, the network of improved highways is not yet comprehensive. Under these circumstances, truck competition has an uneven territorial impact. Competitive reductions will tend to be made where the competition is felt and not elsewhere and charges of regional discrimination will be heard even when the railroads have done no more than to attempt to meet competition where it exists.

## Effects of Non-Rail Competition

Given the rail rate structure, the competition of motor carriers has been most heavily felt with respect to the more desirable less car-lot traffic and the high grade carload traffic moving between principal points. This latter is reported in the manufacturers and miscellaneous category. United States railroads originated 44.3 milliontons of less carload traffic in 1923 when this business was



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of total traffic:

at its peak. Revenues were not separately reported for this class of business until 1928. In that year, however, 37 million tons of l.c.l. (3 per cent of total tonnage) produced 11 per cent of rail gross freight revenues. By 1940 tonnage had fallen to 14.7 million and by 1958 to 4.5 million. Meanwhile, the total volume of such tonnage moving in intercity transportation greatly increased. Miller estimates its annual volume at some 125 million tons in recent years. (Sidney L. Miller, "Federal Regulation of Domestic Small Shipment Services - An Economic Appraisal," 25 Law and Contemporary Problems No. 1, p. 125 (1960). This is the mainstay of motor common carrier transportation. Upwards of \$3 billion in annual revenue is probably involved and the lot sizes and lengths of haul of a considerable portion of this traffic would suggest that it might profitably be handled by rail were a sufficient volume capable of being diverted.

The adverse change in the composition of rail traffic as a result of motor carrier competition is far from easy to observe or document. The categories in which traffic is reported for the commodity statistics of the I.C.C. are broad and many of the items embrace commodities of a wide range of value and level of rates.

Nevertheless, some insight can be obtained. The overall data over the decade 1947-1956 show little except the decline of animals and products and of less than carlot traffic. The data are for tons originated in per cents of total traffic:



THE CHAIRMAN: Order, please.

MR. FRAWLEY: Q. Now, Dr. Williams, we had reached the bottom of page 18?

A. Yes.

- Q. Might I just stop you there. You have "tons", so that you might write "tons" at the top of page 19?
  - A. Yes, it is tons originated...
- Q. "Tons' originated" at the top of that page 19"

A. Yes.

	1947	1956
Products of Agriculture	10.3	9.5
Animals and Products	1.3	0.9
Products of Mines	55.1	55.0
Products of Forests	5.7	6.1
Manufactures and Miscellaneous	25.8	27.6
Less Carlot	1.5	0.5
Forwarder	0.3	0.4

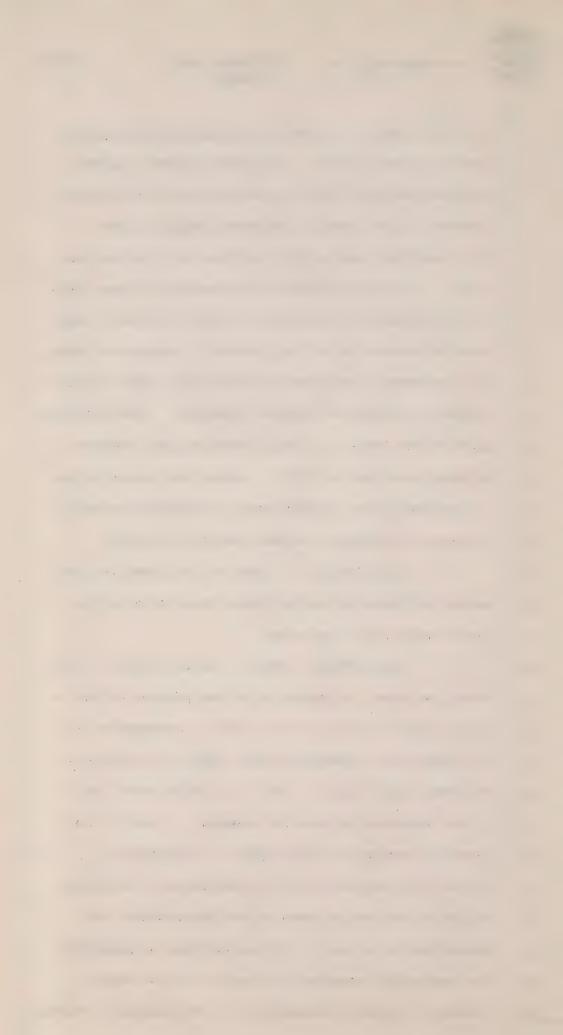
When examination is made of the detailed commodity breakdown, however, some evidence of rail loss of high class traffic is disclosed. For the decade, a decade during which considerable expansion of the gross national product occurred and both terminal years of which were years of high economic activity, the 27 groups of relatively high rated traffic shown in Appendix C declined in rail origination from 69.69 million tons in 1947 to 54.34 million tons in 1956,



or 22 per cent. A further decline to 45.31 million tons occurred by 1958. And this decline occurred despite the fact that total manufactures and miscellaneous carload traffic increased slightly from 397.5 million tons in 1947 to 400.2 million tons in 1956. On the other hand, manufactured tobacco products represent a commodity in which, by dint of much rate adjustment and a long series of suspension cases, rail carriers came close to maintaining their absolute volume of a high net revenue commodity. The greatest part of the traffic in this commodity had, however, already been lost by 1946. During the decade volume slipped only from 390,000 tons to 370,000 tons and a recovery to 420,000 tons was recorded by 1958.

MR. SINCLAIR: Could Dr. Williams tell us where piggyback is carried under this table at the top of page 19 of the brief?

THE WITNESS: On the top of page 19 of the brief, we show piggyback up to the present so far as it is traffic billed under a plan 2 arrangement in the respective commodity dasses. When it comes to a railroad under plan 1, 3 or 4, in which event they do not necessarily know its consist. . . they do not know its composition under plan 1, necessarily . . . it is thrown into manufactures and miscellaneous category which is the last element in the manufactures and miscellaneous groups. The carloadings of piggyback are separately reported, but we do not yet report tonhage originated separately for the piggyback traffic.



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I suspect, considering its rate of growth, it will soon be reported.

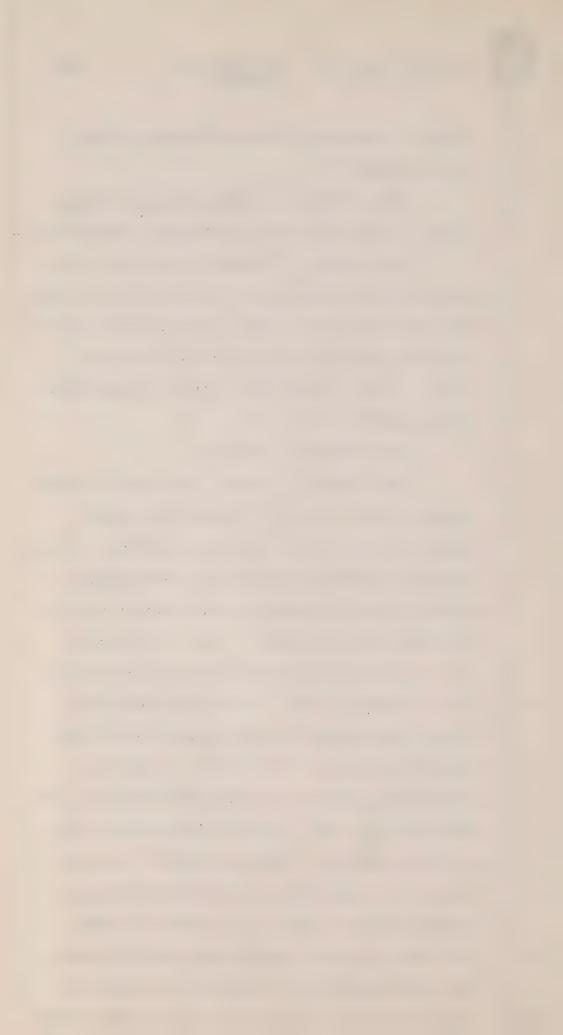
MR. SINCLAIR: On these figures. it would be part of manufactures and miscellaneous, and part in---

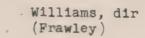
THE WITNESS: It would all be in the broad manufactures and miscellaneous category, in all likelihood unless some plan 2 traffic perhaps would be classified under products of agriculture or products of forest. Plan 1 traffic would all be in manufactures and miscellaneous.

THE WITNESS: Not all unfavourable changes

MR. SINCLAIR: Thank you.

in traffic composition are illustrated by actual declines in the volume of high rated business. In some instances, noteworthy changes in the relationship of volume of articles of high value as compared with low value items are to be found. Thus, food products, n.o.s., declined only from 12.03 million tons in 1947 to 11.47 million in 1956. During the same period, however, the tonnage of animal and poultry feed grew from 20.56 million to 27.92 million. Similarly manufactured iron and steel held almost steady at just above 38 million tons, railroads participating not at all in the movement of increased output. But their volume of the lower-rated iron and steel scrap grew from 20.56 million tons to 27.92 million and many other scrap and waste products also showed increases. Thus, the composition of traffic may be altered adversely when carriers participate in the growth of the





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low grade but not in that of the high grade traffic.

Finally within every class of traffic it will no doubt tend to be the case that volume is retained for those lengths and conditions of haul where rail rates approximate or fall below truck costs whereas the traffic will be lost where the opposite is the case.

Thus, internally in any broad commodity class the same tendencies will be at work which can sometimes be observed among classes.

The general sweep of events can be seen from another set of data. The ICC by a complicated procedure have for many years measured rail tonnage as a per cent of potential, taking 1928 as 100 per cent. This procedure assumes that in 1928 railways were handling as much of the tonnage produced as was potential for them. Later 1947 was used as a base year. If we mesh the two series, we get for 1954, the following percentages of potential as compared with 100 per cent for each in 1928:

Products of Agriculture	78.8
Products of Mines	83.6
Manufactures and Misc.	51.0
Less Carlot	41.4

I suggest that in relation to potential, measured as the Commission does, the decline in manufactures and miscellaneous in less carlot in comparison with potential has been far more severe than it has been in the other two categories shown.

The mesh is not exact, since it leaves out such



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declines as may have occurred between 1946 and 1947.

Although a cumulative increase of 107.7 per cent in freight rates was authorized from June of 1946 to August of 1957, average revenue per ton mile increased only 47.7 per cent during the same period. This was the result of hold downs and competitive reductions not merely, but of an adverse change in the commodity composition of traffic and a slight increase in average length of haul.

To quote further from the Rationale. "An important consequence of the attrition of the more remunerative traffic of regulated common carriers has been to place heavy upward pressures upon the rate level for such traffic as cannot yet be handled by private or exempt forms of transportation. This contracting base of traffic which remains relatively tied to the common carriers has had to bear the brunt of inflationary pressures. The effect has been felt most seriously by the railroad industry from which traffic has also been diverted by competing forms of common carriage. The 'product mix' in railroad transportation has been changed materially, in consequence of which the increase of actual revenues per unit of service has been very moderate by comparison with the increase in the level of rates."

MR. SINCLAIR: Dr. Williams, again so I can understand your statistics, on page 20 in your table does manufactures and miscellaneous included in that



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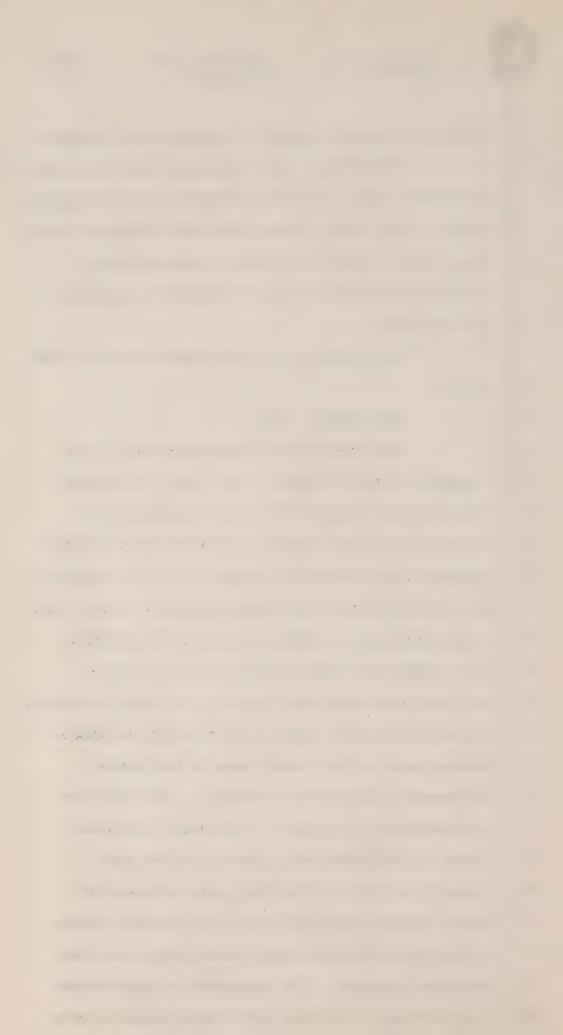
designate forwarder traffic, or has that been exempted?

THE WITNESS: The forwarder traffic is separately reported, and I group the forwarder traffic with less carlot in this case as being more nearly related to less carlot than to manufactures and to miscellaneous, although it is received by the railroad ordinarily in carload lots.

MR. SINCLAIR: In this table it is with less carlot?

THE WITNESS: Yes.

This phenomenon in Canada has been called regularly to the attention of the Board of Transport Commissioners in general rate level proceedings. Whereas in the United States traffic has felt abnormal pressure because railbound either in view of relatively low value which has traditionally entitled it to a relatively low basis of rates, or because the lengths of haul exceed those upon which trucks can compete for other than high rated traffic, in Canada differences in the state of development of the highway network in various parts of the country seem to have added differential territorial pressures. Hold downs on certain basic commodities, extensively used in the United States, undoubtedly benefit the shippers thereof, but they increase the upward pressure of rates upon the middle portions of the traffic stratum just as does the loss of high rated traffic to other forms of transport. The proportion of unprofitable traffic tends to increase under the influence of hold



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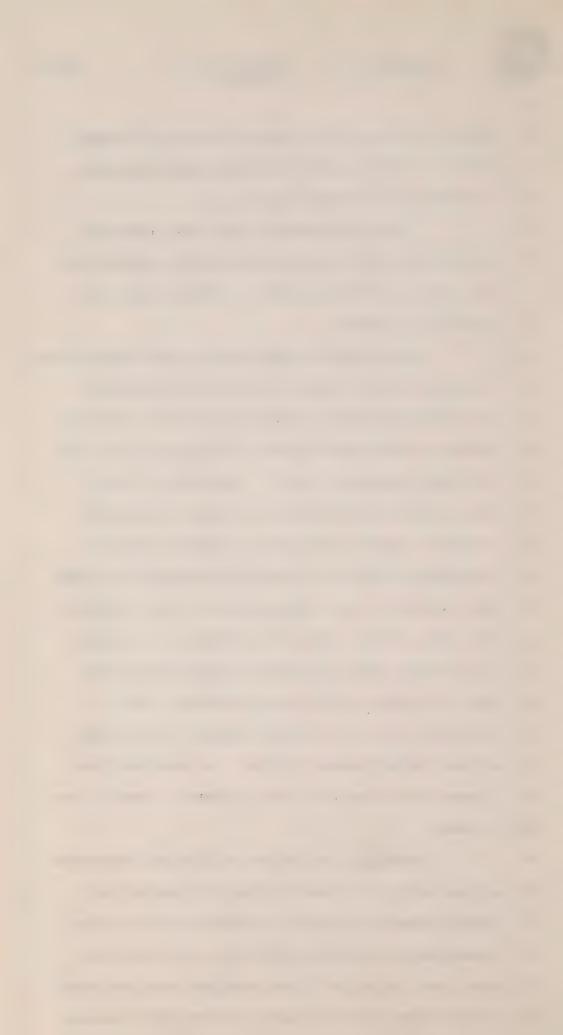
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downs as it does, also, from the failure of distance scales of rates to reflect the increasing proportion of terminal to line-haul expense.

I might incidentally here make some small explanation of this phenomenon to which I referred here three times, since it may not be entirely clear from the way it is stated.

We have had the experience in the United States, certainly, that the major technological improvement which has had important consequences for the railroad industry in the postwar period has been the shift from steam power to diesel power. The effect of that shift has been quite marked in respect of line-haul movement of traffic; the diesel locomotive being of substantially different operating characteristics than steam locomotive, and being capable of use in multiple units, has had the effect of inviting us to increase our trainloads and substantially eliminating a great number of helper districts and spreading crews of line-haul service over larger movement of line -haul movement through heavier trains. We have benefited to some degree from the faster movement of traffic over the road.

Unhappily, no similar substantial improvement has come about in connection with the operation of terminal services by which I comprehend not only the classification function performed in major railroad yards, but also all of those functions associated with placing their cars at shippers' sidings and in moving



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loads from shippers' sidings; the whole range of switching services necessarily performed in all terminals where freight is originated or terminated.

In that situation, we have, it is true, in some cases realized a slight improvement in that through switching, but on the whole that improvement has been either absent or not been proven substantial. So, while we have realized some field and maintenance economies, we have not realized many of the other economies present in the line-haul application of diesel power. And, although we have undertaken in the United States -- and I am sure the same has occurred in Canada -- some major yard improvements in basic classification yards at some major points, we have not found ways and means to hold in check the costs of servicing smaller terminals and performing the necessary switching services in reaching freight houses, team tracks and industrial sidings.

Consequently, we have had a shift in the structure of railway costs represented by an increasing proportion of those costs being absorbed in the terminal operations. That is what is referred to here and is referred to also at a later point.

At the same time that these unprofitable segments are increasing, high-grade traffic hitherto relied upon for internal subsidization has been diverted. Hence upon a continually declining volume of freight for which alternatives are still unavailable falls a steadily increasing portion of the



burden.

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With a stable total volume of traffic and unutilized capacity, railroads face a dismal prospect unless these trends can be altered substantially. What we have been observing in the United States is a process which, over the last three decades, has opened an increasing volume of traffic to diversion. As the process proceeds, particularly in an inflationary period, it results in successive crises marked by the threat of disappearance of railway net income. The process of general increase resorted to as an emergency procedure, however, merely expands the area of competition. It is a self-defeating process, which in the short run diverts additional traffic upon a widened margin of competitive traffic and in the long run increasingly discourages, if it does not destroy, those industries still compelled to rely on rails. Our effort to maintain traditional rate making principles, for which carriers as well as the regulatory authorities must be said to have shared responsibility, has failed. Not only our railroads, but regulated motor common carriers as well are tied to those principles and the motor carriers are in their turn coming under similar and increasingly heavy pressure. In the last few years it appears likely that virtually all expansion in United States transportation has been in the private and exempt areas and in unlawful operations which are spawned in the contest between common carrier rates as they now exist and the costs at which the



Although there has been increasing recogni-

favourably circumstansed can transport for themselves.

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tion of the necessity for sweeping changes in rate structure by the United States railroads, there is not yet broad agreement either on the necessities or upon method. Much experimentation is under way, some successes have been achieved, but not enough has been accomplished to stay the course of traffic diversion to non-rail forms. The necessity to improve the railroad position and the growing belief that much traffic has been diverted to more costly forms of transport under traditional rate making policies led to the

1958 revision of the rule of rate making. Despite

much talk, however, the railroads have not yet seen fit

which would give expression to the cost characteristics

petition which they face. Their efforts at experimen-

tation attract the sharpest opposition of competitors,

particularly of water and motor common carriers, for

than they do the growing body of private transportation

these latter still fear the railroad industry more

within their own forms.

to suggest a comprehensive revision of rate structure

of their own industry and to the nature of the com-

Importance of the Railroad System: If what we were observing in the present development of the non-rail forms of transport were the displacement of a technically inferior type which could be said to be obsolete, the economist would not have cause to complain although others might. This does not, however,



appear to be the case. For each of the several forms of transport -- motor, air and pipeline -- has characteristics which fit it better than the railroad for a part of the transportation job. No one, however, nor all in combination, is capable of performing the entire transportation job without an unacceptable increase in the aggregate cost of transport. The railroad retains an economic advantage in respect of a wide range of essential traffic movements and its comprehensive ability to meet a broader range of requirements than any other form. It must, for the foreseeable future, remain the backbone of the transportation system. This is particularly true in a country of great distances where long hauls of a large variety of goods are necessary.

What is occurring, then, is that the railroads are assailed by essentially specialized carriers each capable of doing a part of the transport task more efficiently than the railroads. A problem of adjustment of great magnitude is presented in which the central problem is to find ways to use each of the modes severally and in combination, in such a way as will conduce to the greatest efficiency in the discharge of the overall transport function. The adjustment is made the more difficult where, as in both our countries, we have an excess of rail capacity in comparision with present and prospective traffic. The tendency is strong to create new capacity in the non-rail forms without any noteworthy reduction of rail capacity, hence



to increase the aggregate of transportation plant which the transportation function must support at a rate faster than the growth of traffic.

Canada has in its railroad plant and organization an asset of great value. This is true not only because the railroad system provides still more than half of its freight transportation requirements at costs below what other forms of transport could manage, but also because the railroad technology has advantages in the long-haul mass movement of general commodities which cannot prospectively be duplicated. Moreover the railroad technology is not mature, much less obsolescent. Indeed technological advance in railroading is as rapid if not more so as in other forms.





## MGUS. STONEHOUSE & CO. LTD. Williams, dir. (Frawley)

The tragedy of the railroads, as it seems, has been a want of earning power adequate to support an optimum rate of application of improved technology coupled with the necessity to spread available earning power over excessive and partly reduddant mileage. United States rail carriers achieved their prewar peak in freight ton miles in 1929 and enjoyed a net income of \$977.2 million in that year. Their 1956 traffic in ton miles was 37 percent above 1929, but their net income was but \$958.8 million. The 1929 income figure has been slightly surpassed indeed only in one year --1942. In the post-war period, moreover, year-to-year variations in net income have been substantial. Average annual net income for the decade of the 20's was \$684.7 million, for the decade ended with 1959 only \$630.3. Since 1939 the AAR index of charge-out prices and wage rates has more than tripled. Hence the buying power of the rail net income of recent years is hardly more than 30 per cent of their net income in the 1920's. Although substantial capital investment was made in that earlier decade, that is in the 1920's, the rate was not sufficient to bring the system fully abreast of technology. How much more disappointing is the record of the decade just ended in the face of the great opportunities which technological advances have opened out. The result is that we have no truly modern railroads with the exception of some recently built and isolated properties devoted primarily to the movement of iron ore. Hence we cannot judge from current



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performance the full potential of the railroad technology withough we must compare it and pit it in the market, in the United States at least, against young carriers of other types with a high level of modernity in their equipment using basic facilities largely provided by government and certainly far from starved as respects capital inputs.

So far as concerns railroads, therefore, the problem which faces them and governments alike is to find means for adjusting their opportunities to the advantages which they are capable of offering the public.

## The Burden of Transition

Railroads have done much of what they could do within the confines of law, precedent and institutions. They have sought to meet competition where they found it by rate and service adjustment with the benefit, in Canada, of the added flexibility afforded by the agreed charge. To the extent they have been able to retain traffic at rates that more than cover the added costs occasioned by that traffic, they have reduced the burden upon shippers who are bound to use the rails. They have sought to maintain solvency and meet the problems of adverse change in traffic composition, growing passenger deficits and price inflation through increases in those rates where no great diversion of traffic was to be expected in the short run. In this process they have encountered opposition and administrative delay, especially in the United States which appears among other things to have necessitated larger ultimate rate



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increases than might otherwise have been necessary.

wis process has bought time, but it does not appear to have solved the underlying problems of the industry or prepared the way for a new and tenable position of some permanance. Moreover it has given rise to conditions which arenot only the cause of just complaint, but which must have effects upon the composition and territorial distribution of economic development and therefore should merit careful attention. One way to put it. by reference to the United States, is as follows:

Substantial, and until the last few years, growing passenger service deficits, a growing less carload deficit, and the whole burden of generating necessary railroad net income are placed upon the carload shippers of freight. Within this last group, deficit traffic is to be found in every major commodity group. These deficits also must be borne by the shippers of such carload traffic as remains profitable. Within this last group -- traffic in carloads that remains profitable -- a growing portion for which competition is active with other forms of transport is becoming steadily less capable of bearing these increasing burdens of deficits in other areas. Hence they fall with accentuated force upon the shippers of traffic which is still rail bound -generally jon wheal traffile ease, too the highest classes intermediate grade non-bulk traffic which is not yet attractive to trucks and low-grade bulk commodities where a substitute water or pipeline transportation is not available.



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This is, of course, a simplification to make a point are is subject to many qualifications. Most of its aspects would appear also to be present in Canada. The Interstate Commerce Commission and the Board of Transport Commissioners have regularly heard complaints on this score in general rate level proceedings, but the issue does not seem to have been squarely faced.

Under traditional common carrier and public utility approaches it would appear that shippers who are called upon to bear such a shift of burden are entitled to relief. They are, of course, entitled in either country to complain about the reasonableness and lawfulness otherwise of any rate which they are called upon to pay. But this avenue is likely to afford scant comfort. For we have never had any practicable abstract tests of the reasonableness of rates. Nor, if the value of the service be said to measure the upper limit of reasonableness, have we ever had aostract tests of value of service which did not involve us in circular reasoning.

Q. I wonder if it would not be well to say a word about what you mean by that question "circular reasoning"?

A. Possibly so and I might illustrate it.

Attempting to measure the value of the service, of course, it to compare the difference in price levels of a commodity at two points between which the commodity might be shipped. If we do that, of course, we run at once into the difficulty that the price of the commodity may well be not a reflection of the freight





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## ANGUS. STONEHOUSE & CO. LTD: Williams, dir. TORONTO ONTARIO (Frawley)

rate itself and certainly could be influenced by a change in the freight rate. We have not, therefore, an independent phase from that kind of a route.

The second possibility would be to compute the cost of production or cost of manufacturing of a commodity at two places between which transportation is in view and between which the rate is to be made. Here again, we run into the difficulty, number one, sometimes we do not have a technical possibility of production. Leaving that aside, where production is taking the position, which is not infrequently the case, that again certain of the costs of production are a reflection of the freight rate, we have no independent approach to the problem. There is also, of course, in respect of the value of service the difficulty that is common in all analysis of laymen that the value of the service to one person or firm has seldom the same value to some other, person or firm. We would define value of service as to what he would be willing to pay for that service rather than be without it but in any attempt to approximate value of service, it is necessary to resort to an average of different demand conditions on the part of individual shippers.

Instead we pursued a practical method which certainly, at one time, could be justified as roughly equitable. We could judge the reasonableness of aggregate rail income by reference to a revenue requirement on return on investment formula. We could thus resort to comprehensible standards for determining



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unreasonab'y low. I's has not been a problem which troubles us in

whether rates as a whole were unreasonably high or

the United States in a good many decades because we have not had railroad earning power that hauls on a level that would bejudged by two standards prior to public utility as being unreasonably high so we have not had to contend with it very much.

Given a reasonable aggregate level of income it was possible to judge the individual rates by which that income was produced in relative terms and to seek an equitable apportionment among classes of traffic and varieties of hauls. Classification standards and distance relationships could be brought to bear in establishing equitable relationships, among rates, given a structure that in general was judged reasonable and subject to the further test that no rates within that structure should be so low as to cast a burden upon other traffic, any rate could be tested to ascertain whether it fell outside the pattern. This was done by the method of rate comparisons. In effect the relative reasonableness of a rate was tested by comparing it with rates in the same or like commodities for similar lengths of haul.

Competitively compelled rates were always held to be rates which cannot be offered with persuasiveness in comparisons designed to test the maximum level of lawfulness for a rate. Nor would I argue for any other rule. So long as the competitively compelled rate was very much the exception and the great bulk of all rates





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were at or near the supposed maximum of reasonableness the rule . rked well. The condition upon which the logic of the method depended, however, appears to have undergone a rapid rate of destruction. For competitively compelled and statutory rates within Canada appear to have become more nearly the rule than the exception. This conclusion is strongly suggested by the data set forth in the December 27, 1957, Judgment of the Board of Transport Commissioners File No. 48269, at p 28. As appears from the Board's Annual Report for 1959, p 34 this shows a growth in proportion of total revenues on carload traffic (as derived from sample waybill analysis) for the three categories of traffic at statutory grain rates, traffic at competitive rates and traffic at agreed charges from 23.6 per cent in 1949 to 42.5 per cent in 1956, 47.4 per cent in 1958. In 1959 the percentage was 51.7. This percentage can be calculated from Table I, page 3, Waybill Analysis, 1959, Board of Transport Commissioners. Indeed these data break down as follows:

	1949	1956	1958	1959
at standard rates	12.3	11.5	10.5	8.6
at competitive rates	8.9	21.0	23.1	27.0
at agreed charges	2.4	10.0	13.8	16.1

Thus the increases in percentage of revenues chargeable to traffic not moving at rates useful in comparisons designed to test the maximum of reasonableness has been in the competitive rates and agreed charges.

Undoubtedly some rates in other categories



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would also be unavailable as valid components in rate comparison. The pattern from which departures may be measured by the method of comparisons thus seems to have become steadily less comprehensive. To the extent it has done so, the logic underlying the traditional test has become attenuated. Further development in this direction will of course worsen the situation. As traffic moving under non-statutory and non-competitive rates continues to decline and as the pressures noted force these rates upward in comparison with the total body of rates, the traditional standard affords no check. Apparently individual rates applied specific apparently individual rates applied specific apparently individual rates applied specific apparently individual rates applied to diverted all traffic.

Such a situation extends a strong inducement to find alternative means of transport and to readjust marketing and purchasing plans to minimize transport. It also becomes an increasing bar to expansion or new development of economic activity in areas or in trades which have no immediate transport alternative in prospect regardless of what where a reallies may exist there. It makes an accepted procedure and standard designed to insure equity serve instead, and increasingly to Justify inequity. Hence it appears that a new test of reasonabless is required. This presents a problem of great difficulty, for although there is an accepted economic standard it is difficult of application. Discrimination finds its justification, in the case of shippers charged rates above cost, o tor the proposition that they will be required, at any rate, to pay lower



rates than if equal rates were charged and volume dropped to the level which such rates would attract.

Where rates move above this level, such shippers are in fact being called upon to subsidize other classes of traffic. The nature of this test and possible ways of applying it will be discussed in other submissions.

Although the adoption of methods to mitigate the increasing burdens falling upon a steadily smaller share of the traffic is important, this is certainly not enough. It does not solve the railroad problem.

Indeed since it suggests a mitigation of the shift it would possibly, without more, face the carriers with disappearing net income at some future point. The railroad problem is an exceedingly complex one. There appears to be no simple solution. Instead a complex set of approaches appears to be called for.



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Possible Solutions: The burden of passenger service deficits, apparently of serious proportions in Canada as in the United States, not only tends to fall upon a diminishing portion of the freight shippers as indicated above, but in a more general sense inhibits the railroads from making manifest in the structure of freight rates their full economic advantage. Thus they are rendered more vulnerable to competitive diversion of their freight business not because of factors inherent in that service but by reasons essentially unrelated thereto. There is no reason other than expediency why any class of freight shippers ought to be called upon to bear deficits in the passenger service except to the limited and probably unascertainable extent to which they require such service for use or standby. There is room for question whether rail passenger services have any persuasive economic reasons for continued existence except in mass commuter and high-density short-haul movements of which the examples in Canada appear to be limited. The economics of air transport on the long hauls and of bus transport in local service are such that it would appear impossible to justify indefinitely continued large scale passenger service. There remains, however, a period of transition especially where the highway net is not yet complete, where conditions make rail service appear essential as a standby and where public attitudes are not yet prepared to countenance major discontinuance of rail service.



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Such conditions would seem to suggest a shift of the passenger service deficit from being borne by the freight service to a system of support by the general public. Segregation of the deficits into a separate subsidy programme might have the additional merit of making clear the cost of continuing passenger train operations in instances where these operations are no longer supported by public patronage and might, thus, assist in accelerating a tailoring of service which appears to be inevitable in the longer run.

The burden of maintaining and operating a

railroad mileage in excess of that required by the volume of traffic is, no doubt, substantial. While it is possible to adjust rail plant and operating practices to a wide range of densities, it would appear that the traffic density of a considerable portion of the Canadian system falls below the level at which such an adjustment can be accomplished. It is not clear that any shortrun solution is feasible. Major lines falling in the category of "national policy lines" have become integrated into the systems in such a way as, doubtless, to prohibit their abandonment. Some greater progress may be attainable in branch line abandonment, especially where near duplication of the two major systems exists and highway conditions permit concentration of the traffic into stations on one of the two lines. Where reasonably feasible such abandonment ought certainly to be fostered rather than opposed, since it may lend help in improving the efficiency of the railroad system



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and thus in strengthening its overall competitive position while reducing the total burden of transportation cost in the Canadian economy. Where public authority stands in the way of the line abandonment shown to be economically desirable, an argument for subsidy could certainly be made. But the determination of subsidy levels and the administration of subsidy in such cases presents obvious difficulties. A concerted effort to abandon mileage would be far more fruitful for the nation, and to the extent accomplished, at least as helpful to the railways.

It would appear to me that the most urgent requirement for attaining a long-run and reasonably permanent solution of the railroad problem is to effect accelerated changes in the rate structure which will more faithfully reflect the economic advantages of the railroad technology and erect defences against further uneconomic diversion of traffic to other methods of transportation. The principles that ought to be brought to bear in the face of growing intercarrier competition are clear enough in the abstract. But rate making theories are not wisely to be enforced by legislative fiat. The rate making, or pricing, problem is a very practical one embracing wide variation of circumstances and requiring flexibility and speed in administration. It is clear, however, that rates above the costs at which shippers can perform for themselves or competitors can offer an equal or better service will secure no traffic for the railroads. The value of the service by rrailroad is coming more and more to be



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fixed by the cost of performing a substitute service by some other form of transport. Many of the traditional classification principles are deprived of their accustomed usefulness in circumstances such as these and this is especially true of such weight as might ordinarily have been given to the value of the commodity in seeking its proper position among the classification ratings. It is equally clear that the continuance of rates above the levels at which competition can prospectively be supplied will invite and encourage such competition to develop and will augment the pressure to devote public funds to the further increase of basic transportation capacity. It is not enough to meet competition after it develops. It is essential to forestall it where the railroad has an advantage and to create a structure of rates which deters rather than invites the spread of competition.

Much has been said and written about the making of rail rates upon a cost basis. Wise pricing practices, however, require attention not only to the cost at which a product can be manufactured or sold but to the market conditions which determine the strength and character of demand. Few would, therefore, urge a mechanical adherence to a cost standard in the pricing of the transportation service. Excessive emphasis, perhaps, has been placed upon cost in a good bit of theoretical writing. But this is largely because the traditional value of service concept and the standards used to measure it require revision and because there



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has been very sharp resistance to such revision. Value of service in the revised sense noted above, continues to be a valid principle of rate making. Generally speaking, however, the range of the value of railroad service above the cost of service has narrowed and this process seems to be continuing. Thus cost is not the only test which ought to be applied to a rate, but every rate ought to cover at least the appropriate marginal cost. Above this, in the face of competition and potential competition rates ought to be fixed as near as may be at the level which will maximize contribution above the marginal cost level.

In the face of present competitive complexities it would appear that carriers ought to be allowed great freedom in the making of rates. They appear to enjoy greater latitude in Canada than has been true in the United States. In a basic public service industry, however, the public is entitled to expect certain things:

(a) That carriers will put in force or continue in force no rates which lie below the appropriate cost. Where traffic can be retained against competition only at below cost levels, such traffic ought to be shed. For it not only burdens other rail traffic, but by encouraging the movement of traffic by a method of transport which is less economical than some other, it burdens the economy as a whole. Many commodity classes within the United States include



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significant volumes of traffic which appear to be moving at below cost levels. In some instances this has resulted from the application of regulation. In other instances it is the result of continuance of precompetitive price practices. In yet others it results from a shift in the cost function, e.g. the increase in terminal costs in relation to line haul, over a period of time which has not been recognized in the rate structure. Railroads will not, except in the short run and for purposes of destroying competition, ordinarily make rates which they believe lie below the cost of service. But rates established close to the level of cost may be allowed, in the absence of continuing review, to fall below a changing cost structure or to fall below the level which changing competitive circumstances require. Where the question is to shed existing traffic which is believed to be handled at less than cost, the relevant measure of cost is, of course, the saving in cost which would be realized if the particular traffic ceased to move by rail. That carriers will, in competitive rate making, fix rates not only above the relevant marginal cost but also at that level about cost which will maximize the contribution to burden from

the traffic in the light of the competitive

circumstances. This would be anticipated of



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carriers in their own interest, quite without put ic intervention. It is noteworthy, however, that carriers in the United States have not yet equipped themselves adequately in market research and in the study of the cost and service characteristics of competitive transportation, so that it appears they are frequently misled. or that they allow rates to become lower than competition requires by default of continuing re-examination, no regular processes for such re-examination having been established.

- That carriers will, in every instance where they (c) have a cost advantage over competitors, reflect the advantage in the rates so as to maximize contribution.
- That carriers will, even where forceful competi-(d) tion does not now exist, examine their rate structure carefully to remove any incentive to the growth of competitive service which is not capable of being made more economical than rail service.
- That a test of the maximum reasonable level of (e) rates be devised and applied as an alternative to the increasingly unserviceable traditional tests, which while expedient at an earlier time, now fail to comport with the economic test upon which the justification for discrimination is based.

It would appear that Canadian railroads still



have open to them opportunities to preserve their position which have passed away in the United States. It is far more practical to adjust a rate structure which will reflect the railroads' economic advantages and resist the growth of competitive transportation in traffic for which such an advantage exists in advance of the development of such competition than it is to force back overextended competitive forms into their proper economic spheres. United States railroads are beginning to approach a broad revision of their rate forms much too late. Happily it is my impression that both of the major Canadian roads have a more lively awareness of the problem than the majority of the United States roads.

The necessity to carry substantial excess mileage with resulting low average freight traffic density while awaiting economic growth to match up and absorb that capacity may yet constitute a handicap of significant proportions. It should result in the short-run marginal cost associated with increased traffic being farther below average total cost than is generally believed to be true in the United States.

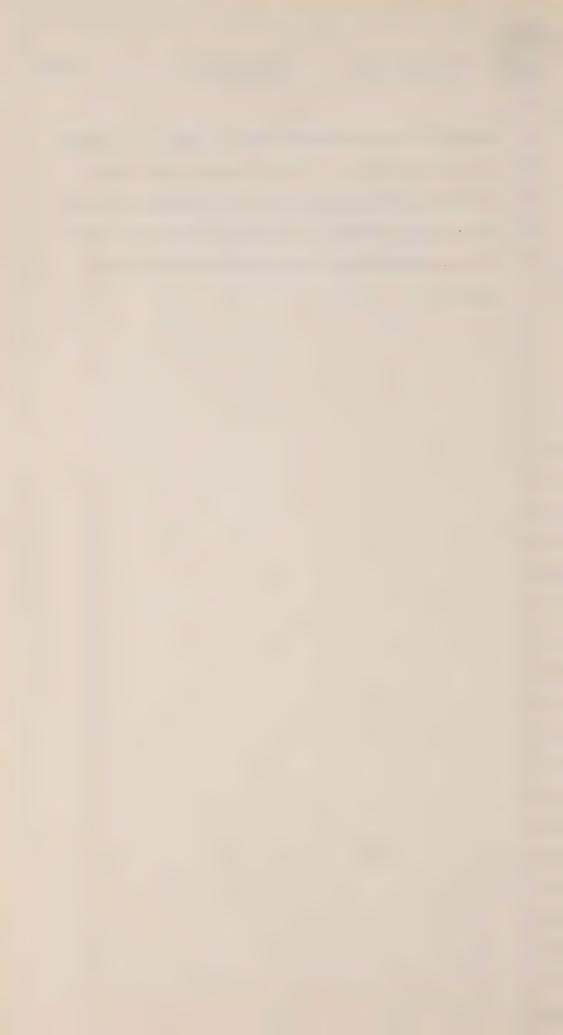
This may afford greater latitude in meeting competition under the principles set forth above. Yet it may prevent, when reasonable treatment is accorded to noncompetitive traffic, an entirely adequate total earning power to keep the system reasonably abreast of technological development. If so, attention might be paid to the logic of further subsidy on account of mileage



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of national policy. In the long-run, with rapid economic growth and an absence of unforeseen developments in other forms of transport, the strong basic economic advantages of the railroads should assert themselves.

deemed to have been built ahead of traffic for reasons



APPENDIX A

## INTORCITY TON MILES IN THE UNITED STATES BY TYPE OF TRANSPORTATION

	Rail*	Water- ways	Coastwise & Inter- coastal billions)	Motor Truck	Pipe Line	Total	Rail as % of Total
1926	490.8	93.0	158.0	5.0	19.0	765.8	64.1
1930	423.2	78.0	160.0	12.0	33.0	706.2	59.9
1936	375.3	86.0	192.0	28.0	40.2	721.5	52.0
1940	411.8	118.1	243.4	62.0	59.3	894.6	46.0
1945	736.2	142.7	117.2	66.6	126.5	1,189.2	61.9
1946	642.7	124.0	229.7	81.7	95.1	1,173.2	54.7
1947	706.7	146.7	206.7	101.7	105.2	1,267.0	55.8
1948	688.7	161.8	210.5	115.5	119.6	1,296.1	53.1
1949	567.3	139.4	214.3	124.9	114.9	1,160.8	48.9
1950	628.5	163.3	233.0	170.2	129.2	1,324.2	47.5
1951	686.4	182.2	251.1	182.5	152.1	1,454.3	47.2
1952	651.4	168.4	248.1	184.1	157.5	1,409.5	46.2
1953	641.8	202.4	264.4	217.2	169.9	1,495.7	42.9
1954	577.5	173.7	270.2	214.6	179.2	1,415.2	40.8
1955	654.8	216.5	278.7	226.2	203.2	1,575.7	41.5
1956	670.2	220.0	274.4	253.8	230.0	1,649.0	40.6
1957	649.4	231.8	268.4	244.0**	222.7	1,617.2	40.0
1958	579.3	189.0	266.6	247.0**	211.3	1,493.2	38.9

<sup>\*</sup> Rail figures include mail and express, as well as estimated non-revenue ton miles.

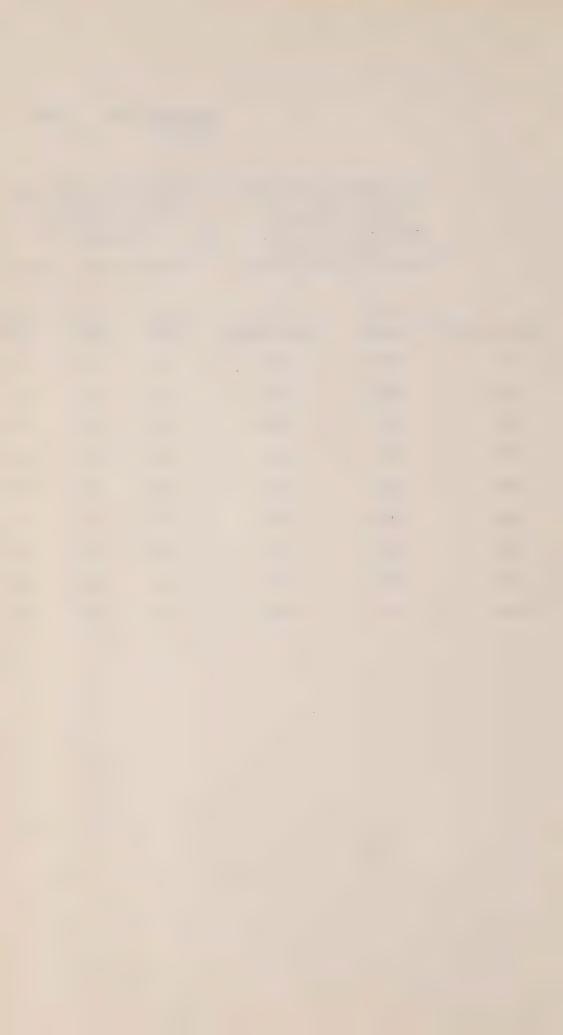
<sup>\*\*</sup> Revised basis of estimate precludes exact comparison with prior years.



U.S. Eastern District
Box Car Costs with
38 per cent Empty
Return, 10-ton Load January 1, 1950 (Cents per 100 pounds) (Cents per 100 pounds)

Docket 28300 Class Rates Excluding Ex Parte 175 and Subsequent Increases

Length of Haul	Out of Pocket	Fully Distributed	Class 100	Class 50	Class 30
10	19.2	21.3	64	32	19
50	23.0	25.7	91	46	27
100	27.3	30.8	114	57	34
<b>1</b> 50	31.6	35.9	133	67	40
200	35.9	40.9	149	75	45
300	44.5	51.1	179	90	54
400	53.1	61.2	206	103	62
500	61.7	71.4	231	116	.64
1,000	104.7	122.2	345	173	104



## Williams, dir (Frawley)

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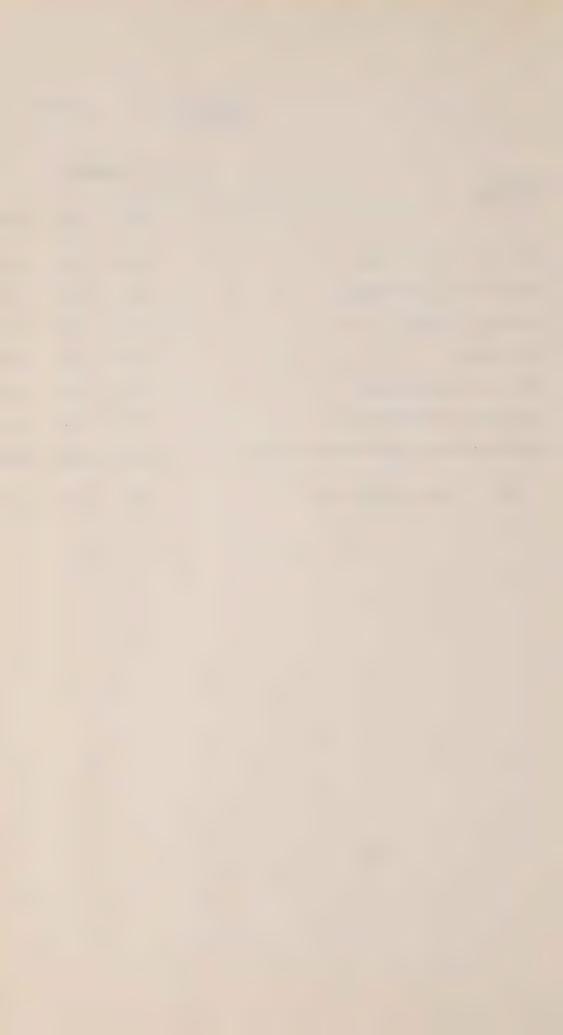
APPENDIX C

## TONS ORIGINATED, UNITED STATES RAILWAYS SELECTED COMMODITIES IN MANUFACTURES AND MISCELLANEOUS CATEGORY (MILLIONS)

	1947	1956	1958
Fuel oil, petroleum residual oils, N.O.S.	16.5	10.4	8.5
Lubricating oil and greases	5.6	3.6	2.9
Refined petroleum products, N.O.S.	7.8	9.8	9.2
Tanning meterials, NOS	0.33	0.11	0.08
Paint, paint materials, etc.	1.5	0.97	0.79
Drugs, medicines and toiler preparations	0.37	0.19	0.17
Copper, brass and braonze N.O.S.	1.75	1.27	0.82
Iron and steel nails and wire	3.55	2.36	1.52
Agricultural implements and parts	1.42	0.77	0.75
Machinery and parts	5.24	4.24	3.14
Automobiles, passenger	2.08	1.06	0.68
Automobiles, freight	0.62	0.24	0.15
Vehicles, motor, N.O.S.	0.85	0.74	0.58
Autos and autotrucks, K.D.	0.62	0.32	0.19
Electrical equipment and parts	1.66	1.43	1.00
Hardware, N.O.S.	0.20	0.08	0.05
Glass	1.09	0.93	0.48
Glassware	0.46	0.39	0.33
Refrigerators, freezers and parts	1.01	0.93	0.74
Stoves, ranges and parts	0.70	0.38	0.27



Appendix C	APPENDIX C		
Concluded	1947	1956	1958
Tools and parts, N.C.S.	0.11	0.04	0.03
Boots, shoes and Findings	0.17	0.11	0.07
Alcoholic liquors	1.06	0.66	0.56
Malt liquors	4.85	3.21	3.03
Candy and confectionery	0.53	0.40	0.35
Containers, fireboard, K.D.	2.33	1.65	1.33
Manufactures and miscellaneous N.O.S.	7.30	8.06	7.60
Total, listed commodities	69.69	54.34	45.31



Q. Dr. Williams, I want to ask your view with regard to a matter. I show you a document -- just the cover of it -- and it is Statement No. 559 of the Interstate Commerce Commission. It is called Rail Carload Cost Scales by Territories for the Year 1958.

Then, I show you another document called
Distribution of the Rail Revenue Contribution by Commodity Groups; this one happens to be 1956; it is
numbered as Statement No. 6-58, and it is dated
Washington, November 1958, and I would like to ask your
opinion as to the usefulness of the preparation of those
statements in Canada and your views with respect to the
advisability of whether you feel this Commission should
make any recommendation with regard to the introduction
of that kind of cost information.

MR. FRAWLEY: Oh, no; I have an idea that perhaps a copy has been filed. They are the well known burden study in one instance, of the Interstate Commerce Commission, and in the other instance the Cost Scales Statement.

MR. MAURO: We questioned Dr. Edwards about that previously.

MR. SINCLAIR: Before the witness answers, Mr. Chairman and members of the Commission, this was an issue that was raised by my friend many, many months ago in the proceedings. It was fully considered by the Commission and the Commission ruled, and in my respectful submission, the question put by my friend to Dr.



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of opinions on that issue, the Commission has stated by its rulings that they are not interested in them, and they are irrelevant, and for that reason I would ask the question be struck out. MR. MAURO: Mr. Chairman, the reason they are

the Commission, and while Dr. Williams may have all kinds

Williams is highly improper in light of the ruling of

brought into this context is that the Commission ruled they would not order a burden study at this time. The Province of Manitoba, as you will recall, in their submission through the Premier at Winnipeg recommended that a burden study be ordered -- something similar to a burden study be ordered. The matter was introduced through Dr. Edwards, and this is a joint submission of both Manitoba and Alberta, and we felt here was an expert in the field, not on whether this Commission should have a burden study done now; that matter is closed.

MR. FRAWLEY: May I just add to that, Mr. Chairman, that I am amazed Mr. Sinclair should say this Commission has ruled that the issue is closed. is the issue I am raising, and what is the issue my friend is talking about? He is saying he resisted the attempt made by us last February for the Commission then and there to order the railways to provide a burden study or to provide basic data upon which we, ourselves, could make a burden study.

THE CHAIRMAN: What you are asking is if it would be a good thing.

MR. FRAWLEY: I will go even further, Mr.



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bility.

not credibility.

MR. SINCLAIR: It is qualification. It is

Chairman: I am asking the opinion of the witness, who
I think is well qualified to express an opinion, with
respect to whether this sort of thing should be introduced
as a routine matter and made available to the Board of
Transport Commissioners and their economic and accounting section. That has not been closed, I hope, at all.

THE CHAIRMAN: You are not opening up again the request to us?

MR. FRAWLEY: Not at all.

MR. SINCLAIR: With respect, Mr. Chairman,

I was listening to my friend rather closely, and if I

am wrong the reporter can look up the question asked of
the witness, but he used the word "worthwhile" -
"in your opinion, are such things worthwhile?" I

object to that.

MR. FRAWLEY: Are you objecting to my use of the word "worthwhile"?

MR. SINCLAIR: My friend, in asking the witness, while he may be knowledgeable about the situation as to how these are maintained in the United States, has introduced in no way any qualification as to his know-ledge of costing and the conditions in Canada that would enable him to answer that question as it applies to the two major railways in Canada and the situation prevailing here. On that basis I also object to it.

MR. MAURO: That would be a matter of credi-



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MR. MAURO: It certainly is. This commission can receive the evidence and treat it as it sees fit.

MR. FRAWLEY: His qualifications are there and I am quite content with them, and I would certainly humbly submit the witness is quite well qualified to talk about burden studies and the cost scale studies of the Interstate Commerce Commission. My friend now shifts from his first position.

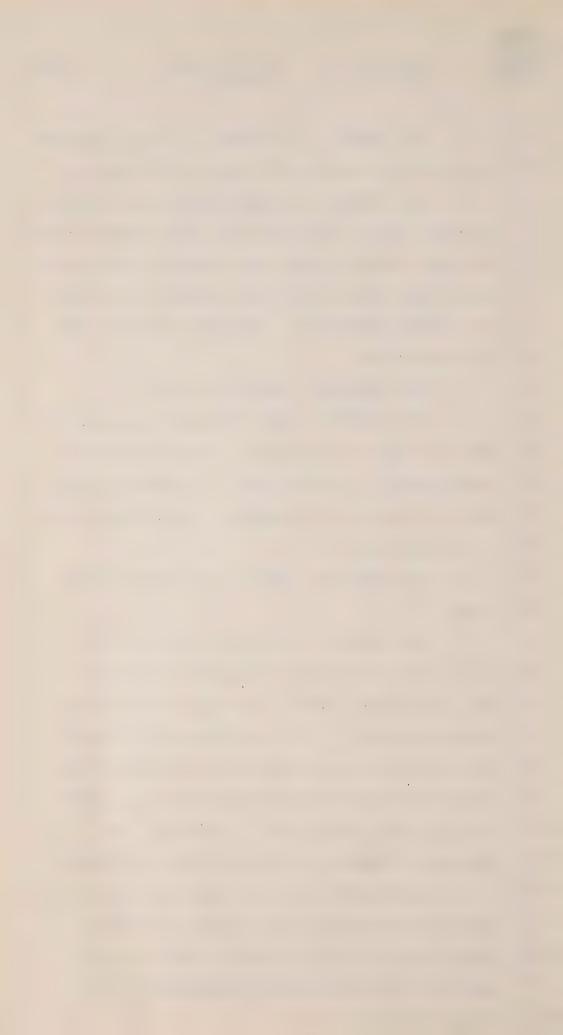
MR. SINCLAIR: I have two grounds.

MR. FRAWLEY: Well, we are not asking that the Commission order a burden study to be developed in our proceedings now. That has gone. We regretted very much the ruling of the Commission; it affected the course of our participation.

MR. SINCLAIR: But you are abiding by that ruling?

MR. FRAWLEY: The ruling is that this Commission would not order the railways to provide the data at that time. That is finished; that issue is dead and concluded. I am now talking about a recommendation of this Commission which we are going to ask, that that kind of information become routine in Canada as it is in the United States. As to that, the Commission is eminently qualified to express an opinion.

commissioner mann: Dr. Williams, your general answer to such a question, if it were given, would follow, would it, along the lines of what you state under Cost Finding in Federal Transportation Policy at pages 9 and 19?



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THE WITNESS: Very much so, I suspect, since we had qui e an examination of this problem made at the time of that study.

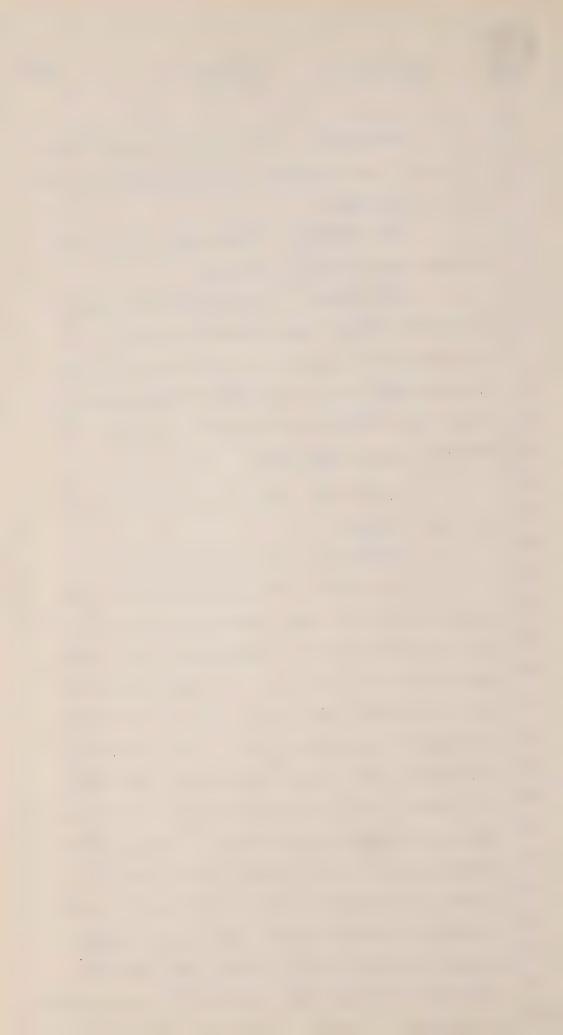
THE CHAIRMAN: I don't think you can interrupt the answer there, Mr. Sinclair.

MR. SINCLAIR: I just want to note that my position is that Dr. Williams has not attempted, or my friend has not attempted to qualify him as a cost analyst expert or as a rate expert or that he has knowledge of the situation as it pertains in Canada. On that basis my objection rests.

MR. FRAWLEY: Well, I am not going to argue his qualifications.

THE CHAIRMAN: Answer the question.

THE WITNESS: Well, it is a question which probably calls for a rather complicated answer. I think it will be obvious to the Commission that any recommendations that ran in the direction suggested, that the cost of the service has become, and must by the nature of economic circumstances become, a more important test of successful rate making in the present competitive era, and will certainly suggest that some kind of cost finding procedures become essential. They are, in the first instance, essential to the carriers themselves, and this is a thing which our own railroads were quite reluctant to recognize because the rail cost finding problem is certainly one of the most difficult cost finding problems that can be presented in the whole field Moreover, it was not a thing traditionally of economics.



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necessary nor a thing the carriers were naturally prepared to some forward with. But certainly it is becoming recegnized by our railroads and increasingly. I think, by shippers who are called upon to negotiate rates with carriers, as well as to contest rates in regulatory proceedings, that cost tests have become increasingly important. They have certainly with us become especially important in the matter of trying to determine in the regulatory process how low a carrier of any kind -- not just railways but other forms who may be in competition with one another -- ought to be permitted as a matter of public policy to go in making When you come down to it, the question that the regulators ask increasingly, especially since the amendment of 1958, is the question that railroads certainly ought to be and presumably are asking of themselves, and that is the question whether the rate reduction proposed will be beneficial to the net income of the carrier. That involves not only, obviously, a determination of what the cost of the service will be, but also an estimation of what the volume of the traffic will be, because unfortunately the behaviour of cost is related to the matter of volume. We have, as you all know, and as this document which Mr. Frawley has put before me indicates, for a number of years had published by the Interstate Commerce Commission a publication called Rail Carload Cost Scales by Territories. This document has become increasingly to be used in the United States. I am not able to speak of that entirely in



a favourable sense, however. We notice, for example, in the repo t to which Mr. Commissioner Mann has referred that cost finding procedures in respect of all forms of transportation in the United States are certainly not as well advanced as would be desirable.





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## ANGUS. STONEHOUSE & CO. LTD. Williams, dir. TORONTO. ONTARIO (Prawley)

We have heard the results of the application of a form which essentially was developed by the Interstate Commerce Commission in the class rate 39 proceedings Docket 28300 and 18310. Their problem at that time was a problem very similar to the one you had in the Equalization case. That is a problem of alleged territorial discrimination in rates, a matter that was really, in controversy, whether it was notably more expensive to transport freight by rail to Southern territory than in the Western territory than in official territory. For that kind of a purpose territorial approaches were reasonable, appropriate and, in the end, the cost finding study -- the first of the sort done on that comprehensive lasis by the Interstate Commerce Commission - suggested that the differences, although there were some, in the average levels in the several territories were not significant enough to justify differences in the scales of class rates that ought to be prescribed.

Now, these data, the formula itself, has been carried forward. These data are annually put out by the Commission. And, in default of anything else generally available and reasonably remained officially so that it does not have to be defended everytime it is put in the record in a proceeding, we have come to use it for a great many purposes that get awfully far from the intended purpose. We are inclined to use it for a great variety of rate cases for which there is involved perhaps a rate on a single commodity between a few areas



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in Canada with which average territorial costs do not prove ver, helpful. If they shed any light, it is probably accidentally rather than otherwise.

There are, of course, methods by which these costs can be adjusted in some degree. The Commission itself provides a suggestion as to a number of adjustments that can be made in the covering material which goes along with the carload cost scales. Some of the major causes for differences in the costs of particular hauls -- what you might call departures from the average of territorial experience -- can be allowed for roughly and, of course, the formula can be employed for special cost studies reflecting the costs on a particular railroad or group of railroads and adjusted to reflect not average but actual costs in particular terminal situations and the like. It certainly cannot be described as, at this stage in the game, in any sense a perfect tool. As a matter of fact, I am a little disturbed by the extent to which we have come to accept it and use it without a recognition of the qualifications that were put around it by the Commission's own cost section itself in explaining what had here been done, and what these results were.

Nevertheless, if one uses it with a proper recognition of its limitations, then it can become a useful instrument; and we are in the unhappy situation of not having any other. I have been of the opinion, and we recommended in the Department of Commerce study, that a great deal more work ought to be done on this







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in view of the fact that our rail carriers are increasingly recognizing -- and some of our motor carriers lakewise -- the fact that they must have, if they are to do a rate-making job intelligently, better cost information than they now have. Quite a little work is going forward in some of our carriers in that direction to improve what we now have before us.

In the meanwhile, this set of carload cost scales certainly has usefulness, if it is properly interpreted and properly applied. My concern about it is more often that it will not be properly interpreted or properly applied. It has gotten to the point, however, where it is used as the basis for screening proposed reduced rates in the Commission's Suspension Board. It is used as a way of separating, you might say, the sheep from the goats as to whether there is a rate that is apparently a satisfactorily compensatory rate or a rate as to which there might be some question as to its compensatory character.

It is an important test in determining whether the rates ought to be suspended or they ought not to be suspended. It is a thing that has caused a good deal of grief to carriers' competition with the railroads, and has been complained about considerably.

I would say, though, that the out of pocket cost formula that is used by the Commission is conservative enough so that unless you have quite exceptional cases present it can provide such a rough test ... certainly not a conclusive test in the case of



a close kind of an issue that involves important competitive interests.

It does, of course, enable a good bit of broad study to be made. This kind of thing is translated into the second document which deals with the question of the distribution of rail revenue direction. The one depends on the other. The cost finding procedures are necessary to produce the cost element which enables the burden distribution to be shown.

Now, this enables us to see in a rough way, and subject to the conditions that have to attach to the cost studies themselves, what the apparent position of various commodity groups is. It serves, certainly, as a kind of a screening devise. It is not, at its present state, I think, sufficiently acute as an analytical tool to enable us to deal with close cases without going further, but I think it has been in our case in the regulatory side and to shippers and carriers alike a very useful approach as a rough approximation, and it cannot purport to do much more than that, unless you supplement it with some additional studies and you supplement it with some adjustments from the scale costs as shown in this publication.

We would be hard put to go forward in applying the principles that we are now trying to apply largely on the railroads own initiative, however, if we did not have some basis for considering in



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regulatory procedures the level of railway costs and things -- 3 ome basis for using them in the suspension process -- as a rather automatic matter.

My hope is that we will not misuse them and we will develop more perfect instruments because the present problem, after all, is not a problem of pricing average traffic; it is a problem of pricing how traffic movements in which one certainly will expect that in a great many cases the cost of movement will depart, and perhaps depart significantly, from what are shown as average territorial costs.

That is certainly a long answer, and I do not know for certain whether it was responsive to the question.

THE CHAIRMAN: In short, what you say is it represents a test and not the test?

THE WITNESS: It does represent a test.

THE CHAIRMAN: But not the test?

THE WITNESS: It is sort of the first test that necessitates more when you get into close situations.

THE CHAIRMAN: But not the final test?

THE WITNESS: Not unless the case is one that is pretty obvious and clear-cut.

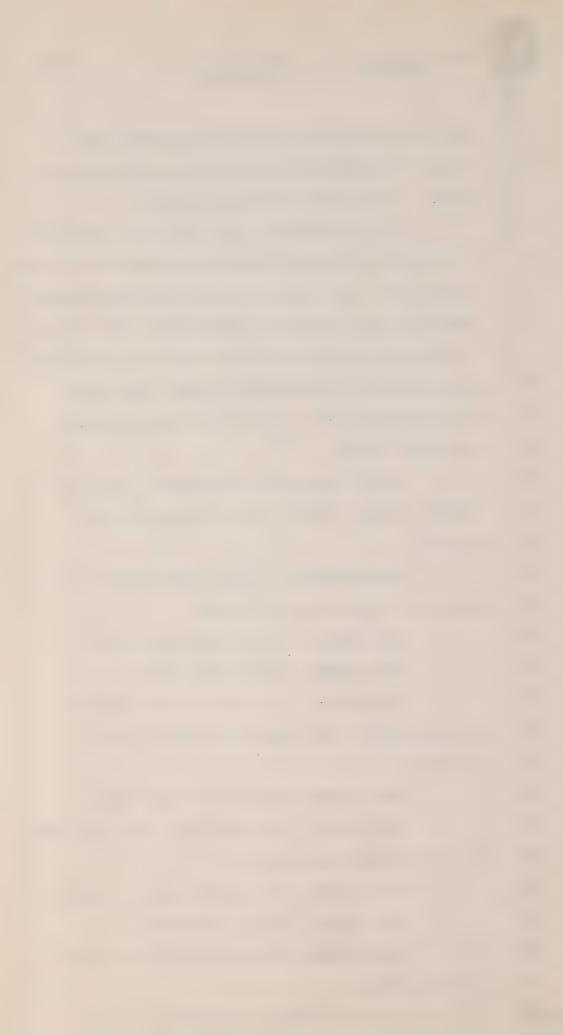
THE CHAIRMAN: Are you finished, Mr. Frawley?

MR. FRAWLEY: Yes, Mr. Chairman.

THE CHAIRMAN: We will start at 2 o'clock

with Mr. Cumming.

-- We will adjourn now until 2 o'clock. --





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ANGUE STONEHOUSE & CO. LTD. (Cumming)

-- On resuming at 2 p.m.

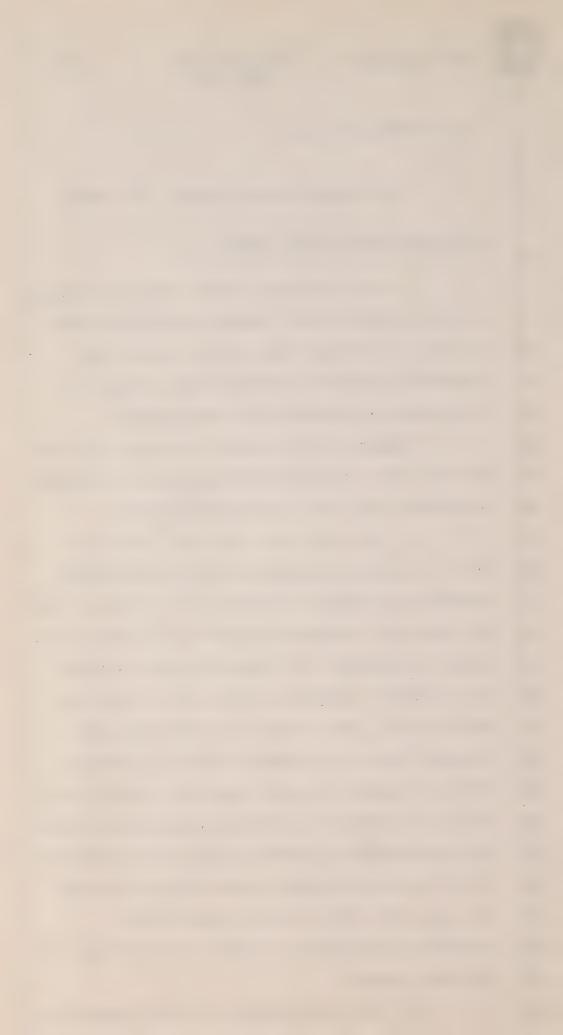
THE CHAIRMAN: Order, please. Mr. Cumming? CROSS-EXAMINATION BY MR. CUMMING:

Q. Dr. Williams, on page 7 of your submission. dealing with this general question of discriminatory pricing, you point out that, and you use the term "commercial and market competition" were allowed in large measure to determine rate relationships.

When you refer to market competition, are you referring there in the United States to off-shore market competition, or is this an internal situation?

A. No, this is in large part, that is, at least an internal situation. There are undoubtedly examples of an external situation, one of which, or one that involves a combination would be such a thing as our sugar rate structure, in as much as sugar is both an item of domestic production and an item of import in which we have what amounts to a nation-wide rate structure, and we would describe that as a structure determined largely by market competitive forces, but it embraces both external and internal competitive forces. The term would be applicable to both kinds of situations, but most commonly the market competition that we have been concerned with in rate structure has been competition of alternative domestic sources of supply in particular markets.

Q. What I was thinking of in this connection



is this, Dr. Williams: with a system of regional railways in the United States as compared to our national or two national systems, is some of what is apparently market competition really a form of carrier competition:

A. Indirectly that is true. I usually discuss market competition in the classroom in order to try to make it clear how it works by pointing out the fact that it gets translated into a rate structure largely because the efforts of various producing centers or regions to reach a common market involves different carriers in a competitive relationship.

If we have, for instance, in a coal rate structure, which is perhaps a good example of an adjustment to market competitive forces, a situation where coal mines are ordinarily located on a single railroad — that is, an individual mine seldom has service by more than one railroad — we may find that one mining field with a number of mines is dependent on one railroad, while another which is competitive in the same general market is served by a different railroad.

Market competition, therefore, translates

itself into carrier competition, but not the competition

of parallel routes. But it is because the railroads

themselves are competitive, even though they are serving

different sources of the traffic, that this thing gets

reflected into an adjustment of the rate structure.

Q. What kind of competition would exist in this sort of situation, Dr. Williams, say, citrus fruit moving from California and Florida, which I assume move



over different railway systems, into the New York market

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A. It does.

Q. -- Is that carrier competition?

A. We would describe that as market competition. In point of fact, what you have really is the competition between Florida carriers, which obviously are interested in promoting the Florida crop, and the transcontinental rates, which are interested in promoting the movements of Galifornia crop and of the Texas crop. But we would use the term "market competition" to describe that. In order to make it understandable, or make understandable why it affects the rate structure, you have to go on, however, to discuss the resulting competition of railroads to develop and generate in their own territories as much a share of traffic going into the market as possible.

Q. I am sorry, I did not mean to interrupt.

Are you through?

A. Yes.

Q. The railways -- we have heard here so many times that it is not the function of the rate structure to offset the geographical advantages or disadvantages, certainly, in the Canadian context, and I am just wondering if you would comment on that in connection with the role which market competition can or should play in the making of rates? That is, internal?

A. Well, I think at least formally and in principle we take exactly the same attitude under our law.



geographical differences or circumstances or the differences in economic circumstances, other than what might be called the transportation condition.

Nevertheless, as a practical matter, in our own

We generally take the position that it is no part of the

regulatory function to adjust rates with a light to

Nevertheless, as a practical matter, in our own railroad situation it becomes necessary if competition among railroads is to be reasonably stable that where there are strong market competitive factors there be some manner of a compromise of those marketing conditions.

And we have time and again recognized the propriety of that being done. The Interstate Commerce Commission is, of course, on record on numerous occasions in saying that the regulation of transportation rates has nothing to do with the neutralization or offsetting of economic advantages or disadvantages, and yet, interestingly enough, there are a number of cases in which it is hard to read anything else either into the decisions or the language used in that the Commission accepted and indeed confirmed carrier decisions that run directly in that effect.

So, I would say we have a principle which is quite the same as yours, yet pernaps we honour it in the breach almost as frequently as we honour it by observation.

- Q. Do you think those breaches are supportable?

  Are they sound? Should we have them in Canada?
- A. Well, that is a difficult question. An economist rather takes a dislike to them on the grounds that when you ignore in any measurable degree the relative



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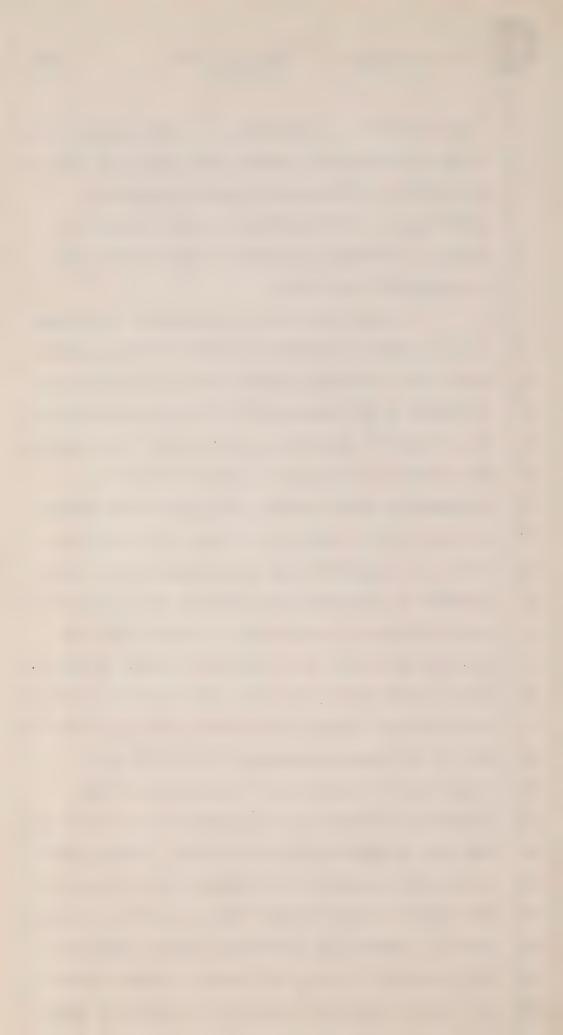
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of two producing areas into a common market, by that very process you are tending to stimulate a degree of production in a location that is a less economical location, all things, including transportation costs, considered, than the other.

On the other hand, our regulatory process had

costs of service -- for example, in putting products out

to go to work on a situation already existing in which these kinds of things had been done for long years. A great deal of the commerce of the country had come to be associated with adjustments of that kind. And, moreover, the process of adjusting to changes in economic circumstances in one section, as compared with another, is likely to be a rather painful one. So that it has seemed to us expedient and, on the whole, wise to make a number of concessions with principle that would cushion some of the shock of adjustment on the one hand and, secondly, of course, we in the United States, at any rate, place a great deal of store on having competitive sources of production. We have collectively through the carriers and the rate making procedures which we have and a regulatory authority over the years come to the conclusion, although we may not have stated it quite this way, that it is better for us to accept a certain amount of what the economists would define as inefficiency in the economic system in order that we might have a greater degree of competitive distribution, market competition, and the like. We accept the benefit in which we have a good deal of confidence, which is not capable of being



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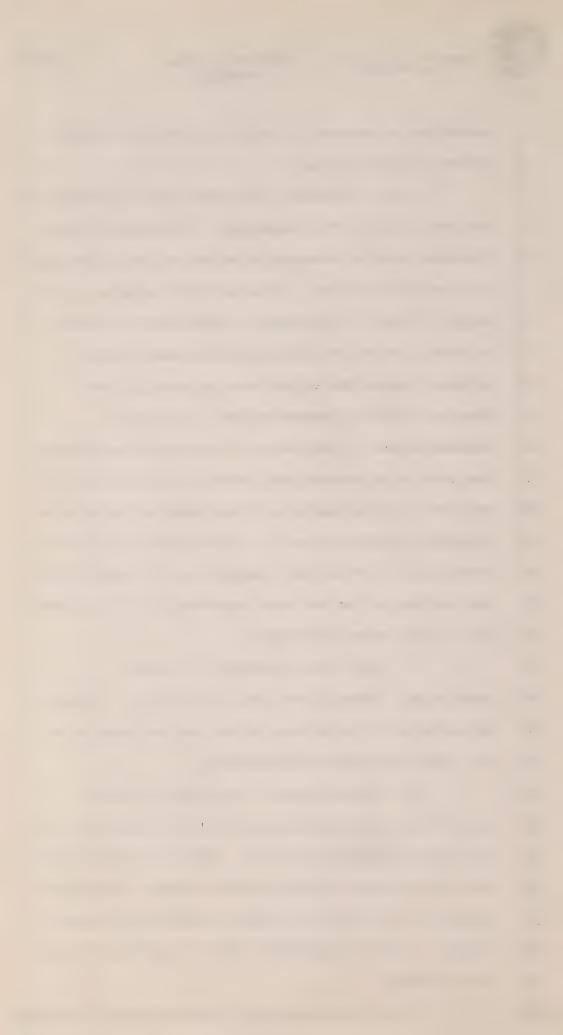
quantified or measured as being superior to a strictly economic basis of rates.

Now, that system, of course, again like some of the early part of this discussion, is a workable enough situation when the transportation was entirely performed by commercial for hire transportation agencies. It has become difficult to maintain relationships of that kind as sharply as private transportation comes into the picture, because the shipper who can move his own transport will be governed by the cost of that transportation. It may well be that if we have affected some kind of adjustment that departs from cost, we will discover it either has to be broken down on the side of commercial transportation or a significant part of the traffic will go to private carriers and the equalization that was sought, or the equal opportunity in the market will, in any event, disappear.

Q. Well now, the factors of market competition, I take it from what you say, will justify the reduction of rates even in the complete absence of any element of carrier competition?

A. In the absence of any direct carrier competition, yes, and by direct carrier competition we mean point to point competition. That is to say, if you have both of your railroads serving between Winnipeg and Calgary -- let us say all traffic between Winnipeg and Calgary -- that we would call direct competition between two railroads.

If we are dealing with different points, however,



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marketing commonly in Winnipeg and located one on one of the rallroads and the other on the other, that is what we would refer to as market competition; noticing, however, that the market competition has in fact brought

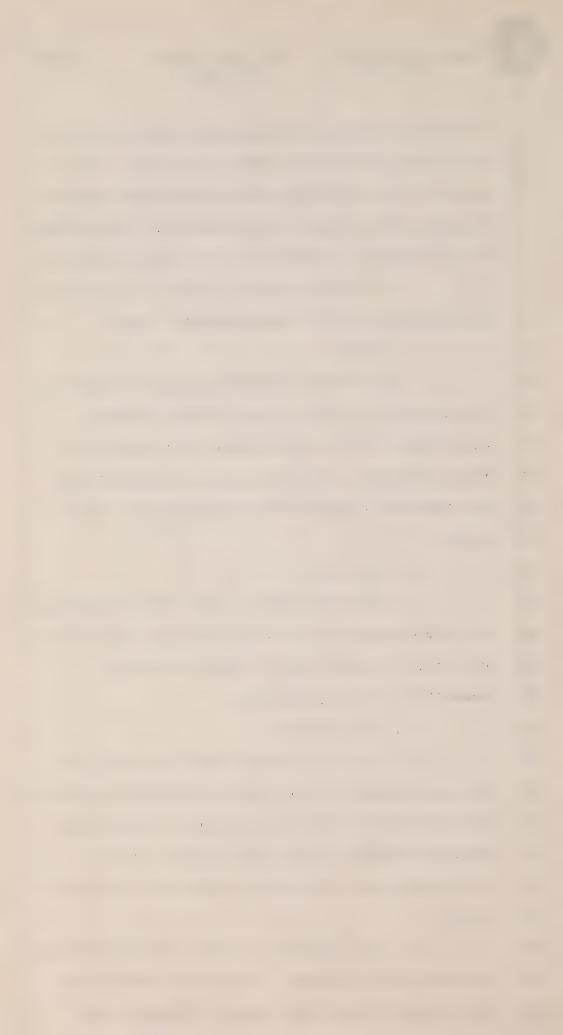
the carriers into competition, even though indirectly.

- Q. You are familiar, I take it, Dr. Williams, with what are known as transcontinental rates?
  - A. Yes.

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- Q. And they are established, as I understand it, in order in part at least to meet off-shore competition at the coastal points. For instance, a transcontinental rate might be put in between Toronto and Vancouver to meet off-shore competition at that point?
  - A. Yes, yes.
- Q. And that rate may under those circumstances be lower because of that competition than a rate from an intermediate point closer to Vancouver than the competitive rate so established?
  - A. Yes, quite so.
- Q. And we have heard that that is the case

  from many sources. Do you think under those circumstances
  that the element of market competition, assuming that
  there is a shipper of the same commodity at an
  intermediate point, should drive down that rate to the
  coast?
- A. Well, this is a question that is not easy to answer in the abstract. If one has a condition in which imported commodities can be laid down on the



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go to the extent of justifying, in your view, different rates given to different shippers whose own internal operating or production costs may vary in order to

British Columbia coast on a basis that would not permit Canadian : purces of production to meet that competition except with reduced rates, than it appears to me that so long as the rates that are used for that purpose are in the first place compensatory rates, in the sense that they return more than the added cost of handling that traffic, whatever it may be; and, secondly, are as high as is possible in the light of the import competition to sustain a Canadian participation in the market, then no one could properly take objection to those rates. nor would it follow that because the rates had been reduced in that competitive circumstance rates elsewhere would require to be reduced.

This is one variety of a meeting of competition where there are external factors beyond the control of the railway companies, and the best they can do for their net revenue position and, therefore, for the overall position of railroad transportation, is to meet that competition, if they can do so at a compensatory rate.

Q. And I suppose the propriety of it would be measured by the extent to which the railway could maximize its net revenue position? Would that be your opinion?

Could this question of market competition

A. Yes. I would think so.



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competition at a common market? A. Well, I think that it makes bad economics

enable, say, a high cost producer and shipper to meet

to do that. On the other hand, we have any number of examples of that sort of thing within the United States.

We have, of course, a rather sharp prohibition of personal discrimination in the Interstate Commerce Act. This does not, however, prevent us from doing something of the sort you suggest, where we are dealing with shippers located at different points and not shipping under precisely similar circumstances. We would then have a situation which would not be responsible to section 2 of Part 1 of the Interstate Commerce Commission and would not come under the prohibition of personal discrimination, per se. And, certainly, we have in a number of rate structures done that sort of thing, more commonly in the case of producing areas that generally encountered higher production costs than other areas. rather than individual producers.

But I would think the principle is extendable to the case of individual producers. As I say, it makes bad economics. About the only justification you can offer from the economic point of view, perhaps, is to admit that where situations of this kind exist you cannot, without considerable pain, dispense with inefficient procedures immediately right off the bat, and that an adjustment period makes some sense in so far as the freight rates may in the past have encouraged the continuance of such relative inefficient



production, it might be well to mitigate the shift.





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## ANGUS. STONEHOUSE, & CO. LTD. Williams, cr.ex. TORONTO. ONTARIO (Cumming)

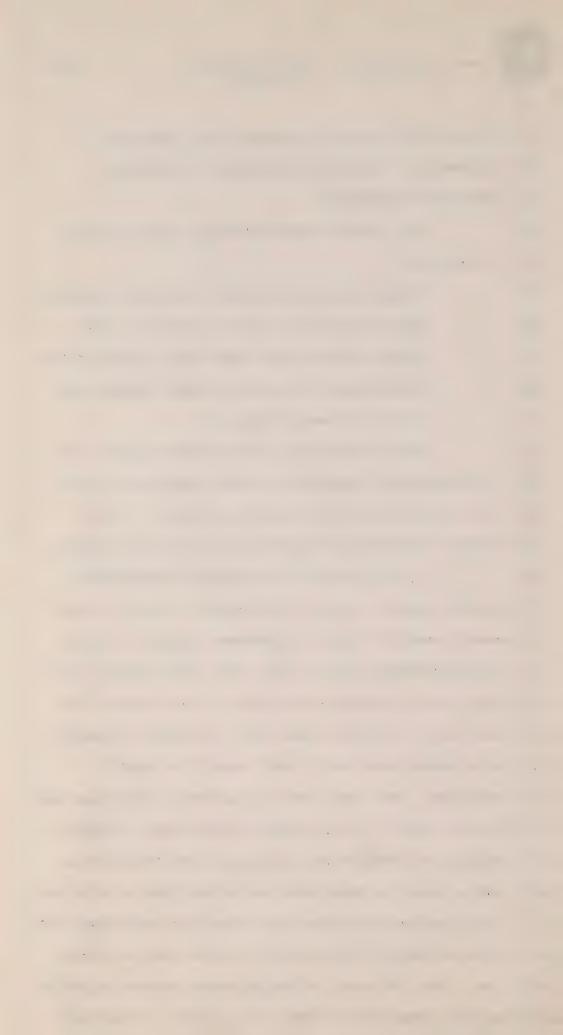
On the whole I think it is rather poor policy for railroad rate structure consciously to encourage inefficient production.

Q. Further down on this page, Dr. Williams, you refer to:

"Thus, mileage scales have often been uniformly applied over large areas, equally to light traffic branch lines where good loading of the plant cannot be secured so that average unit costs must remain high..."

Would there be any justification in your view for differential charging of traffic which moves on the main line as against that which is moving on low density lines where unit costs may be said to be higher.

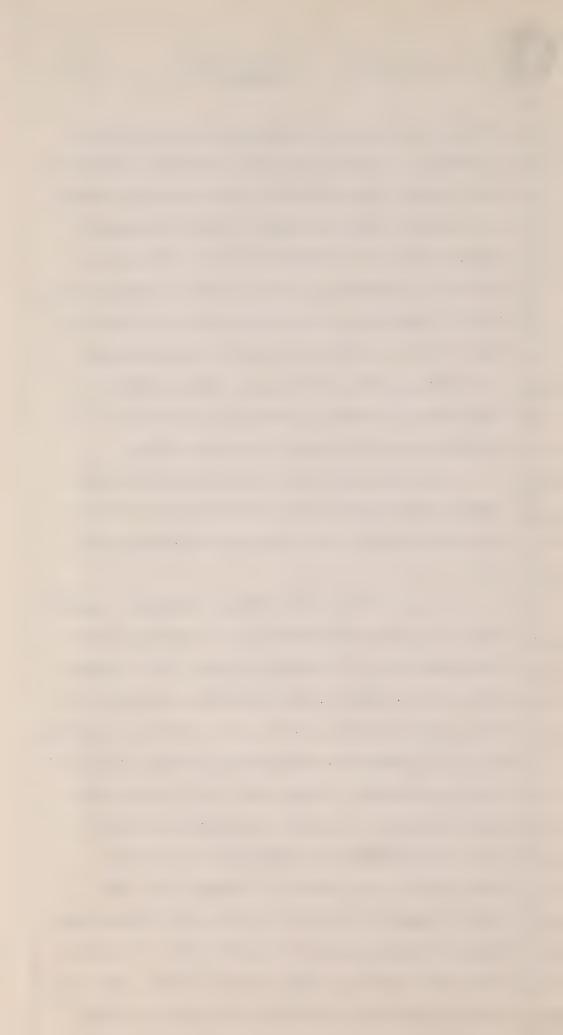
A. Oh, there is an excellent justification from the point of view of the economist because if you were to make that kind of adjustment you would tend to direct producing activity into main line locations, you would tend to increase the volume of the business over main lines and reduce production. Of course you would get a better reduction in cost towards an overall efficiency. The case, however, becomes a troublesome one from the point of view of public policy when instead of starting out fresh with a clean sheet you are starting with a situation where such scales have been in existence for a long period of time and it has been recognized that rates on branch lines are apt to be the same as a min Here you have a situation where economic injustice has been committed on branch line points. It has been



done so in reliance on the proposition that that kind of efficiency of rate making will continue. Investments have been made and clearly it is not the kind of thing that one would want as a matter of public policy to disturb quickly or overnight or without some kind of a period of transition. This is a sort of thing, however which it would seem to me as an economist we ought to begin to move a little bit towards in transportation rate making. That is to say, we ought to commence to make some differentials, perhaps not in the full scale knowledge of cost showing of the United States.

Q. Do you see in the long run a practical rate structure which would reflect those different costs as between high density main line and low density branch lines.

A. I do not think there is anything impractical about it as far as determining what reasonable level of rates ought to be. The problem to me is most largely a problem of how fast it may be reasonably acceptable to move in that direction. We are in a position, of course, and it is a rather odd position that because of the fact that we necessarily average, under these circumstances, branch and main line traffic, we make the railroad method of transportation appear weak precisely in markets where it is likely to encounter this most strange competition as between major points where trucks have good highway access and you will have a balanced traffic and you have a highly rated traffic. This is a system which seems to me cannot indefinitely survive



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as long as we have these competitive opportunities external to the railway systems.

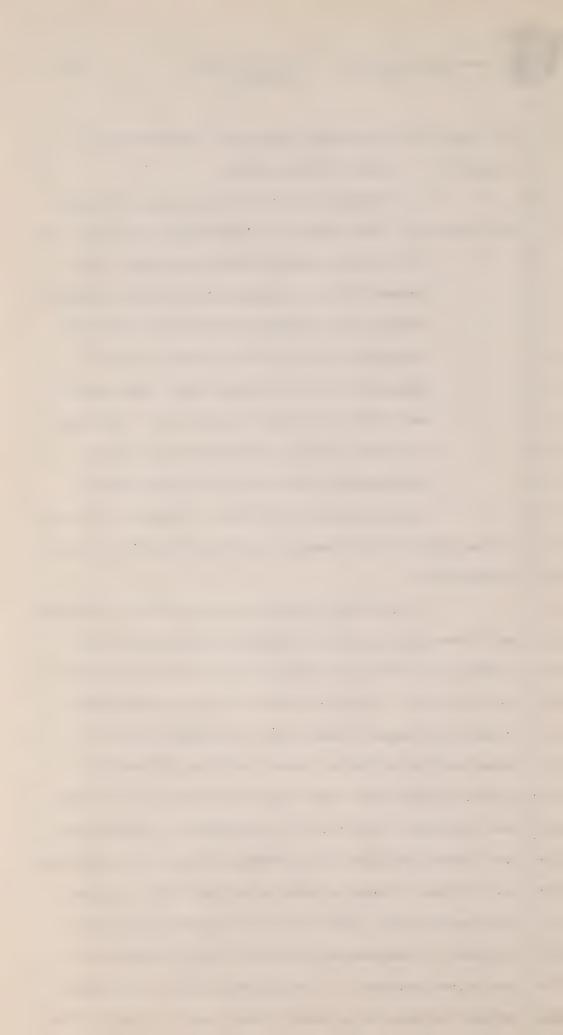
Q. Turning over, if I may, to page 10 under the heading of "Development of Competition" you point out:

"In both the United States and Canada water competition via the Great Lakes and connecting channels were undoubtedly the most important exception, but so far as it was in fact competitive with railroads this transportation was capable of being brought under some degree of control and its packaged freight rates differentially related to the rail rates."

Did you intend to omit the competitive impact

of the effect of the Panama Canal from this list of water competition?

A. Well, of course, the Panama Canal was opened at a time during the first war and closed briefly and reopened so its effect did not come to be felt until the early 1920's. I think of that as a period when other competition began to show signs being significant. We developed in the United States out first, inter-city trucking during the first world war which was on a very small primitive scale but it occurred in a period during the 1920's. Our first transportation by air was accomplished in 1918 and it began to develop in the 1920's. It was also in the 1920's that we, for the first time, really adopted a comprehensive policy for the improvement of our inland waterways. I would include the Panama Canal as part of this great general development to competitive



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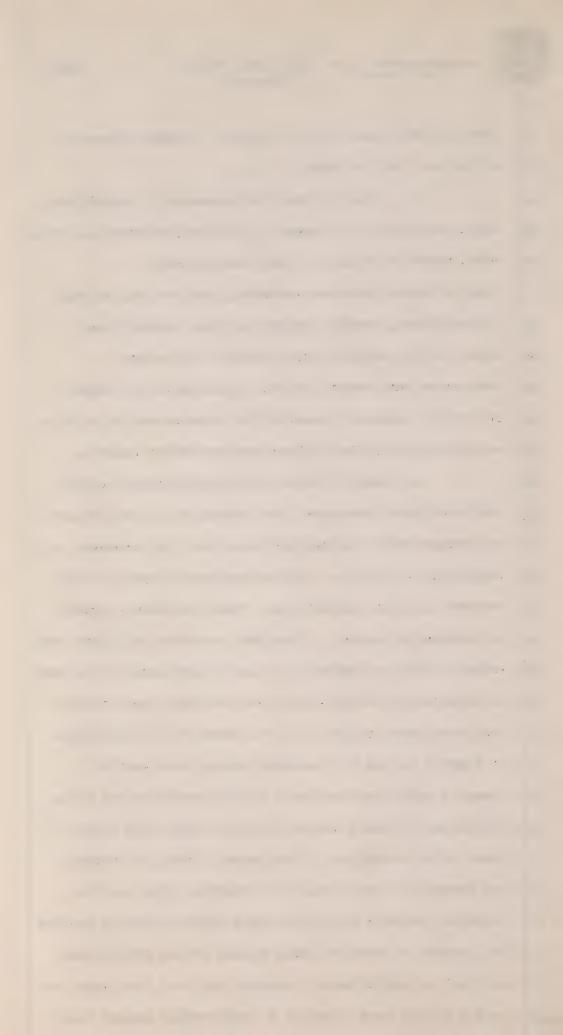
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forms in the decade of the 1920's. I think it was one of the earliest of these.

Q. Going on with the sequence of competition which you speak of on page 12, you pointed there has been development of these at least several other transportation agencies including, and you say in the United States, certain inland waterway competition. I wonder if you would be good enough to give the Commission the benefit of your views as to the impact of the St. Lawrence Seaway on the transportation picture and particularly the railway transportation picture.

A. Well, I think it is rather early to say very much with assurance. The seaway up to the present has demonstrated the kind of thing that was expected by industry. It has been categorized most largely for the movement of bulk commodities. There has been a change of movement of grain, it has been possible for Upper lake vessels to go to Montreal; it has become possible to move on advantageous terms Quebec and Labrador iron ore into the Great Lakes region. If one looks at the statistics of traffic up the St. Lawrence Seaway this year as compared with the first year of its operation one thing that seems to stand out is that the growth has been in these bulk commodities. Now, some of them, of course, are competitive with railway movements; iron ore for instance can move into the United States to steel centers for certain of them at least either by the Great Lakes and rail or the Atlantic Seaboard and rail from there on. In the latter case there is a considerably longer rail



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haul and a higher revenue realized by the railways. Much of that traffic that moves over the seaway so far, however, does not represent competitive diversion from railways. A good deal of interest is centered on the question as to what extent a general cargo would develop via the seaway which would represent that diversion from the Atlantic coast and the Gulf coast ports in the export and import movement which would deprive the railways of a haul from the middle-west for a movement into the Great Lakes because the ranges of haul would very likely be within trucking distance and quite possibly a good part of the traffic would reach the Great Lakes port by truck than by rail. Our experience so far has been with the development of general cargo that the Great Lakes has been rather dissappointing to those who were enthusiastic about its possibilities. This may be a short term picture of the general cargo in the export and import fields who, of course, place considerable store on the quantity of service available measured in the terms of ocean transit time and the frequency of service available in terms of the number of direct services available to various ports in the world. We do not know too much about just how responsive general cargo traffic is to rate differentials and how far it may be responsive to service differentials but up to the present time the service that can be generated within the Great Lakes has been deficient as that compared to within your gulf ports by a wide margin. That is one of those things we commonly encounter in transportation, the type of traffic, the absence of



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traffic, difficulty with good service where the traffic cannot be made to move.

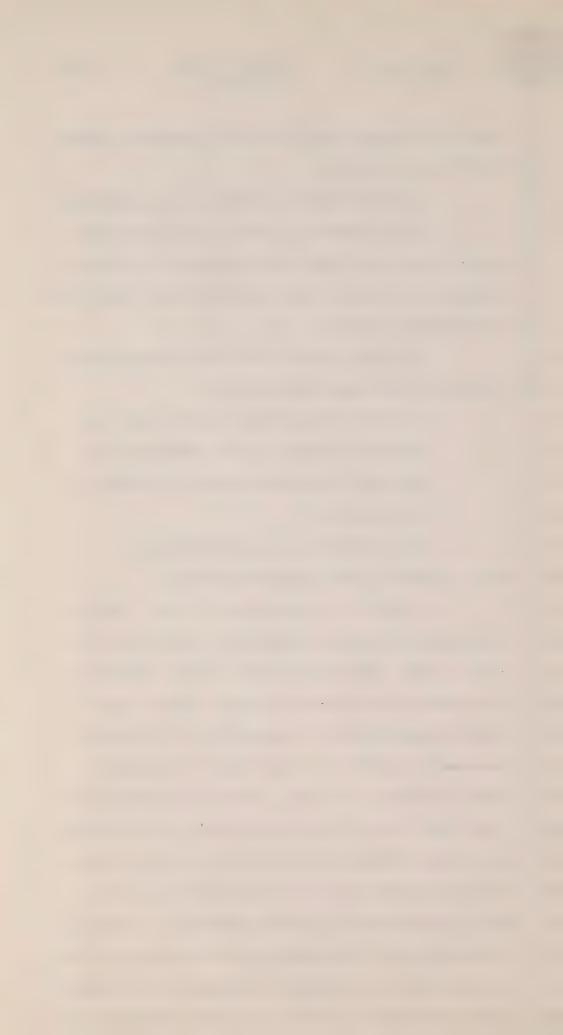
- Q. You get into a chicken and egg situation.
- A. Yes, this is a case in the Great Lakes general cargo also. There are some things such as the position of the Great Lakes port but I think that is the most important problem.
- Q. Then, a small point that arises a little further down this page where you say:
  - "... hence it would not be unreasonable to calculate the whole of the intercity truck ton miles (including private and exempt) at 4¢ a ton mile."

I am intrigued to know why is it, as a whole, lower than the regulated revenues?

A. Well, it may be or may not be. That is something on which one is required to speculate but at least a little light can be shed on that. Number one, it is noticeable the things that are contract, our regulated contract truck transportation is generally conducted at somewhat less cost than our regulated common carriage, if you will. This is the result of the fact that contract carriers generally encounter much less expense under the head of sales as well as under the head of rate construction participating in rate making organization and tariff preparation. Partly it is the result of some opportunities on occasion for the

contract carrier to tailor his operation to the specific

traffic and secure a better load factor. When you go



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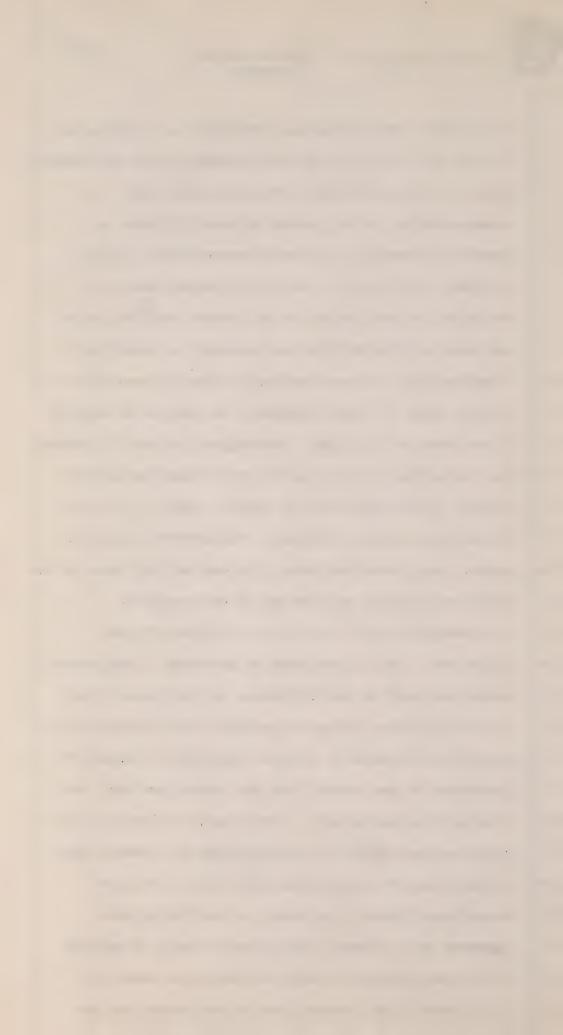
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into private transportation, admittedly we do not know a great de . about it, we have no quantitative information but any of those who have been associated with transportation for any period of time will know of countless examples of private transportation. curiously true that in some of our states that the registration fees for so called private vehicles which are handling freight over the highways for commercial companies pay less registration fee for the same type of vehicle than do common carriers. The notion is that the common carrier is using the highway for public purposes and the private vehicle is not, even though the private carrier is the subsidiary of General Foods. This is a rather funny notion. Secondly, the private carrier is almost unregulated completely, it may maintain none of the specified accounts or make any of the specified representation and it adds up to a figure of some importance. What I have done is attribute a requirement under the light of the difference in the probable cost of transportation taking the notion that it would not be proper to attribute to private operations of which are conducted at less charge than the common carriers, the same revenue equivalent. I think one could argue it the other way and use it as the Department of Commerce once did in a report it made some years back. The most significant factor, I am sure, is that the private operator as a general rule is very careful to provide only those services in which he can get an excellent load factor. The private carrier has always had the



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A. Well. to take the matter of the Tationale

common carrier service to rely on for shifts in his volume; he has them to rely on for his small and inconvenient shipments and he uses them as a standby and provides his service to bring his best load where he can get a good load factor and best terms.

- Common carriers run into the same problems Q. as railways?
- A. Yes, and you cannot expect to find a load factor on a common carrier as well as you will find on a well conducted private carrier operation. In the case of the private carriers the question is then raised as to whether their accounts are on a comparable basis with those of common carriers. In the Southern territory there are truck mile costs in the order of 35¢; with respect to common carriers they run below 40 to 45 cents and in some cases they are getting as high as 50 cents. It is because of the probable cost of conducting a private, in contrast to a common carrier that I used the figure and that is arbitrary and simply put in as a basis for getting some sort of an order of magnitude.
- Q. In answer to my friend, Mr. Frawley's request for you to expand on this question of exempt carrier, you outlined these major disadvantages of exemption. I wonder if you would tell us what is the rationale of the justification behind the exemptions that were granted or the inclusion of this particular class of carriage in the exempted category and also, whether in your view, those exemptions should be narrowed.
- first, the rationale for the agriculture exemption is not



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completely clear. The feeling was that in the handling of agricul iral products between the farm and the first point of entry into the stream of market there was present somewhat unusual circumstances which required a high degree of flexibility in the transportation system. We would have to have trucks to follow the crops as they matured across the country and there was a desire to insure that the farmer-owned trucks and the farm co-operative truck was exempt -- it should have been exempted. In any event, in view of the fact the Act was not the Act of private carriage we had a combination of political power on the one hand in the farm groups and on the other hand the feeling that there was real need for a flexible system of collection of crops at the farm which could not be had under a common carrier form of regulation. We got an exemption which I think interested everybody including the members of Congress and the Senators who argued pro and con at the time the Motor Carrier Act of 1935 was under consideration applied and was intended to apply to the movement of farm products from the farm into the first channels of marketing. However, the language that was put in the Act left some great problem of construction. There is some interesting class we could use, possibly green beans. With green beans you put them in boxes and roll them on a truck as they come out of the fields and everyone would admit they are unprocessed. You go to work and bundle them up in rice boxes and put cellophane covering so is this processed or still unprocessed? Suppose you go further



and you go to work and can the beans; is this processed; or not? Yu get into this kind of question on every commodity that can be moved in the agricultural category. The I.C.C. had to decide whether these commodities fell within the exemption or did not. It took rather a conservative attitude which tried to hold the ratio of these exemptions down. On the other hand, it was found initially and by the decision of the Supreme Court the thing was very carefully excepted to the point where it began to be generally worrisome. We got to the interesting question of an exemption designed to benefit the farmer and now there may be the General Foods Corp. under the buyer's lable with viscerated frozen chicken—

That is unprocessed.

A. That was the situation. We come right up against the fact that it was entirely possible that it could be construed that all canned goods were being exempt which would have hit at a very heavy load of traffic both for the regulated and railroads and even the intercoastal steamship companies. In the face of that it did go so far, after a great deal of controversy in the Congress, as to make a revision of the law which in effect accepted exemptions which the court had already undertaken to explain as the basis for the continuance of the exception. We also specifically deleted from the exemptions a number of commodities, for instance, coffee was exempted under the bulk exemption. They decided at the time that the liquid and the dry bulk, in the case of water transportation, it was not generally regarded



as true that bulk transportation coast-wise or on the
intercoast 1 waterways or on the Great Lakes of liquid
bulk or dry bulk commodities are within the range of
this exemption or, as a rule, were truly competitive
with any form of transportation. Railroads have never
really competed with the movement of bulk on the Great
Lakes over the bulk movement of petroleum on the Atlantic
Seaboard between the market and the Atlantic. The
rationale was that it was not especially competitive with
anybody else and the parties concerned, petroleum
companies and coal companies did not desire regulation
so why should we give it? More recently, however, bulk
petroleum has come to the realm of competition with trunk
pipelines which is regulated and the regulated carriers
by water on the inland rivers a particularly are
competitive with the exempt bulk carriers for the same
commodities and we have an increasing demand in favour
of cutting that exemption. I am not sure whether I
answered all aspects of the question.

Q. I asked you about the rationale and the second leg of my question was whether or not in your view exemptions of this sort which would seem to have been extended substantially, should be reimposed.

A. I am strongly of the opinion that we cannot really run a transportation system that is partly regulated and partly not regulated. My general phylosophic disposition is in favour of reducing the scope and impact, the regulation rather than increasing it. If it would seem possible to make progress in that



direction I would not be inclined to advocate extending regulation to presently exempt areas. However, if we should make the decision that we arenot going to relax regulation but instead that we are going to enforce our present regulation especially in the motor carrier area where we have a tremendous amounts of unlawful operation, then I would have to say that if this is decided we cannot pursue it satisfactorily unless we get these exemptions off the book.

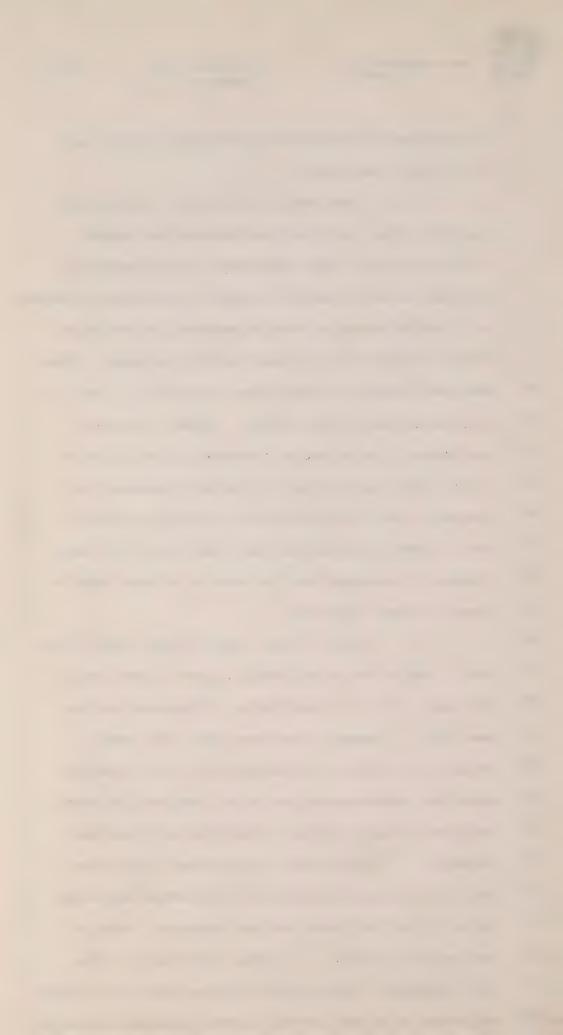


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In that case I would certainly advocate that we cut back on the exemptions.

Q. Thank you, Dr. Williams. As you undoubtedly know, and it appears through the course of the sittings of this Commission, one of the major problems is this question of general percentage increases—a problem which you have experienced in the United States and which is very much to the fore here. There have been numerous suggestions advanced as to the possible solution to this problem. Some of them are: hold downs, limitations to increases on the basis of a flat cents per mile basis, tapered percentage increases, a rate structure more closely approaching a cost of service basis, and some combinations of these. I wonder if we might have the benefit of your views on those proposed solutions?

A. Well, on that I don't think there is any ideal formula for accomplishing a general rate level increase. It is a regrettable circumstance that we need them. Generally they come under very heavy pressure of economic circumstance and in a situation where the revenue needs are quite immediate, so that a relatively simple system of increases is a practical necessity. I would hope, if we can get out of the serious inflationary spiral that the better way to get out of it is for a more precise system on a more or less selective basis. I think any form of a rate level increase is not in the long run beneficial to the railroads or to the general economic position because it



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is bound to produce distortions and to open a greater range of competitive problems.

- Q. Over on page 24 you say, "The necessity to improve the railroad position and the growing belief that much traffic has been diverted to more costly forms of transport under traditional rate making policies led to the 1958 revision of the rule of rate making." Would you explain -- and I thought you might have done it in your evidence in chief -- what was done in 1958?
- A. It was very simple. It was merely to put in the Act words to the effect that the rates that no one form of transportation would be held up for the mere purpose of protecting the traffic of another.

  This is a thing which neither our commission nor the courts have yet construed as to its final and certain meaning, and it is still in controversy as to what it means. Clearly, it does have to be taken along with other sections of the Act including the declaration of policy. It was a very simple amendment, and that is all there was to it.
- Q. On the next page you speak of the experience the railways have had, and point out there has not been any noteworthy reduction of rail capacity. What is the reason behind that? Why has not that, in your view, been pressed forward more vigorously?
- A. In the United States, at any rate, I think part of the cause is that having as many rail companies as we have, and so much in competition, at one point and another across the country, no railroad individually



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is at all anxious to eliminate mileage into a point from which it mar be able to generate some traffic unless the condition becomes one where the losses are hopelessly burdensome. We have not had arrangements hitherto which enabled very much cooperation along those lines, or any great enthusiasm on the part of the railroads for that kind of approach. We have abandoned substantial mileages of branch lines which had, in effect, lost their traffic and which did not involve a competitive situation very much between railroad companies. There, the railroads have been impeded by the regulatory hurdles they had to get over. There has been a considerable lag because of the necessity to bring proceedings seeking the right to abandon because of the solicitude of the commission on the whole for public demands, even though sometimes unsubstantial, for continuance of service.

THE CHAIRMAN: Local resistance?

THE WITNESS: Yes, local resistance, some of which is perfectly understandable because you may get grain merchants or coal merchants who cannot readily turn to something else.

THE CHAIRMAN: We have that in Canada too.

THE WITNESS: I imagine you would have.

MR. CUMMING: Q. Do you think there should be any significant change in the United States in the attitude of the Commission on the question of the treatment of abandonment applications?

A. I think the Commission has become rather more receptive and probably a little more expeditious



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in handling them as well as serves shandonment proceedings, but I don't suppose we will get any really large issues in that respect unless where of the present moves to consolidate competing rations regin to bear fruit. Until we do that we will not have opened up to us the opportunity for the railroads themselves to take the initiative in abandoning or reducing the status of substantial mileages of lines. I think with us consolidation is a prelude to a significant reduction in line haul capacity. We don't know where we will stand on that because have not had a really controversial case dealt with by the interest of maission in this postwar series.

Q. So far as the Canadian picture is concerned, I take it from what you say on page 35 that you feel a concerted effort to a mother maleage would be far more fruitful. What do you suggest, having in mind the experience of opposition to a redundant -- what do you suggest as the proper to de work to should be applied, and generally, what do you support the the manner in which they should be handled?

In the last analysis I suppose there is no way of getting round the fact the mandonment of the line must rest on an east las of pudgrant as to whether the interests of the railroads and the public in the better economy of transportation with 1-suit from abandonment and the reduction of in this on other businesses outweighs losses that will be sustained by people dependent on the line of railway in question. This, I



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think, requires an exercise of judgment. My own feeling about it wo ld be that the thing that is quite commonly ignored in regulatory consideration, at least in the United States, is the overall effect of abandonment of mileage that is now little used on the general transportation system — the efficiency of the transportation system taken as a whole — that broad public interest, although it should be represented by the Commission, tends to move into the background if it appears at all. One finds a consideration merely of the magnitude of the losses shown by the railroads and the loudness of the people who contend the need for the railroad service. I don't think there is any magic formula for that or anything one could put into legislation which would give us a nice way of deciding it.

Q. On page 34 you point out, "Major lines falling in the category of 'national policy lines' have become integrated into the systems in such a way as, doubtless, to prohibit their abandonment." The national policy lines to which you refer there—what are they?

earlier Royal Commissions called by that name, and bearing in mind the history of the development of your railroads, where it appears that for reasons of national policy subsantially more transcontinental lines of railroad were laid down than would certainly have been required on a basis of pure economics. Taking a look at the three lines existing north of the lakes, between the



east and west they carry a substantial volume of traffic, important and it doe. appear there must be connected industries on all of them, and although it is very likely on the overall system a better job could be done with fewer lines, it would seem impossible now to effect an adjustment. It seems Canadian railroad history suggests it was because of various aspects of national policy, interallied with the position taken by the railroads at that time, a good bit of mileage got constructed that on pure economic grounds would hardly have been put into existence.

Q. Dealing with rate matters again for the moment, at page 32, after discussing rate making methods and the situation generally, you say, "It appears that a new test of reasonableness is required. This presents a problem of great difficulty, for although there is an accepted economic standard it is difficult of application." I wonder if you would elaborate on that -- what you mean by the test of reasonableness? What is it, and what are the difficulties in its application?

A. I think Mr. Roberts' testimony will go much further in that respect than what I had proposed to say. Generally, however, from the point of view of the economist, a departure from uniform rates, or equal rates as we might say, is justified under the circumstances that you find in the railroad service, within limits. We permit what might be called an upward discrimination in principle in order to permit



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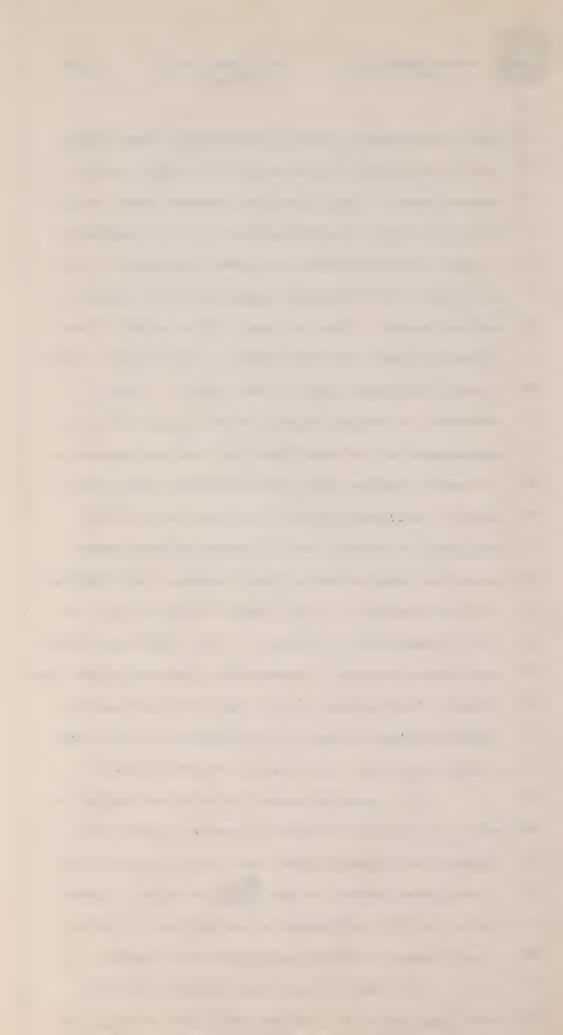
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that the railroads develop by encouraging lower grade traffic mov ments at rates which do not bear a proportionate share of their fixed and overhead costs, on the proposition that if we do that we permit an expansion in the total volume, and therefore a reduction in the unit costs and ultimately a reduction in the burden of the high rates. That is, they will also fall below ultimately what an average level of rates would require in order to sustain the railroad system. A test, therefore, of whether rates have got so high as to be unreasonable in the sense that they tax the shippers of the traffic charged such rates above what those same shippers would have to pay if an equal rate policy were used, represents the discrimination that passes beyond the range of the ordinary economic justification for discrimination. I say that the application of a test of that kind is difficult. It is difficult among other things because it necessitates forecasting what the volume of traffic would be at equal rates and, such a forecast having been made, a determination of the level of equal rates that would sustain the rail plant.

- Q. Again in connection with rate making, on page 37 you say, "In the face of present competitive complexities it would appear that carriers ought to be allowed great freedom in the making of rates." Have you in mind any limitations on the railways' freedom to make rates in Canada that ought to be changed?
- A. Well, I am not as familiar with the actual application of your own restraints as would be



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Q. How essential, in your view, is the

desirable to answer that question with reference to the Canadian si wation. It seems to me that in general, however, greater freedom is certainly warranted than has been customary in the United States and that what we generally require for the maintenance of a reasonable position for the public on the one hand and a reasonable latitude for the railroads on the other is to secure appropriate standards for the control of minimum rates on the one hand and maximum on the other leaving freedom between for adjustment as the carriers see fit in the exercise of their managerial prerogative. We suggested in the Department of Commerce studies that a measure of minimum rates would be the appropriate marginal cost level, and we also said that so far as things now stand and in view of the high degree to which our rates depart from any such cost standard it would not be inappropriate as a rough approach, and as a way of getting started, to use the Commission's out-of-pocket costs recognizing all of the deficiencies there may be in those costs in respect of particular types of traffic that fall some margin apart from the averages. So that when I talk of greater latitude I had in mind especially the situation that our own railways have been in over a period of years and in that they have been, I think, more seriously tied than your own in meeting competition, and that partly results from the fact that they re-regulate a larger part of the competition than you do in Canada.



establishment of minimum rates, having in mind that you say on page 38, in paragraph (b) and continuing over to page 39, "That carriers will, in competitive rate making, fix rates not only above the relevant marginal cost but also at that level above cost which will maximize the contribution to burden from the traffic in the light of the competitive circumstances. This would be anticipated of carriers in their own interest, quite without public intervention." Do you see any real danger in abolishing any legislated minimum of rates?

A. I certainly do in the United States, and perhaps a description of the reasons that I think so with respect to the United States can be translated by some of you into whether it has any relevance with respect to Canada.

Back in 1954 and 1955 when the cabinet committee on transportation policy and organization was considering this matter, they were inclined to recommend a wide range of freedom for our carriers and considerable revision of the law. Upon further examination of that situation we came to the conclusion in the later Department of Commerce report that the time was probably not ripe to go quite that far. One of the distressing difficulties here is that few, if any, of our railroad companies are equipped, in fact, to know what their own interests are with respect to rate making. They do not have regular organized proceedings for cost finding or cost application. The situation is indeed in such a shape that one of our very large railroads is content to feel it



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makes a very substantial contribution if it takes the Form A cos 3 -- developed from its own figures and not the territorial average costs -- and then looks at the rates which exceed 400 per cent of the fully distributed cost, and on the other side to look at those which represent only 50 per cent of the out-of-pocket costs or the Form A, on the notion that it is quite possible all those are unremunerative rates. They think they have enough of a test looking at rates within that range for the present, so they don't have to worry about more refined cost finding techniques until some time in the I took the attitude we needed a continuance of minimum rate control not because the economic situation, so far as the economic structure of transportation goes, compels it in theory, but rather because they have operated under regulation, so far as our railroads go, since 1887 and substantially since 1906 and they have not found need to nor have they developed the kinds of deals that many other private businesses find basically essential in order to exercise a pricing function. So that, we recommended on the one hand some real progress and until we started and had such deals we still required a minimum rate restraint. We were fearful if we eliminated it we would find ourselves in no small difficulty. We did propose, however, that the Commission in looking at minimum rates look at them more from the point of view of economics than from the point of view they employed in the past. --- Short recess.



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I do think that a better judgment about it

THE CHAIRMAN: Order, please.

MR. CUMMING: Q. On page 39, in paragraph

(e), there is the suggestion "that a test of the maximum reasonable level of rates be devised and applied as an alternative to the increasingly unserviceable traditional tests...". Would you venture a definition of what the tests should be for the maximum reasonable level of rates?

A. Well, I think the only definition I could give is that a maximum reasonable rate ought not to exceed what would be a level of average rates that would produce the necessary return to sustain the railroad system at a level of traffic that such rates could induce.

THE CHAIRMAN: Just and reasonable?

THE WITNESS: What that means is the only way that such a level could be ascertained according to that principle is to make a study that, admittedly, involves some degree of speculation as to what would occur, especially on the demand side, and to ascertain it in effect by calculation.

It would necessarily be a moving standard.

It would have to be applied with some degree of flexibility. I do not think ultimately there is any hard and fast answer to this question of what amounts to a just and reasonable level of rates.

can be reached with a different sort of test than that



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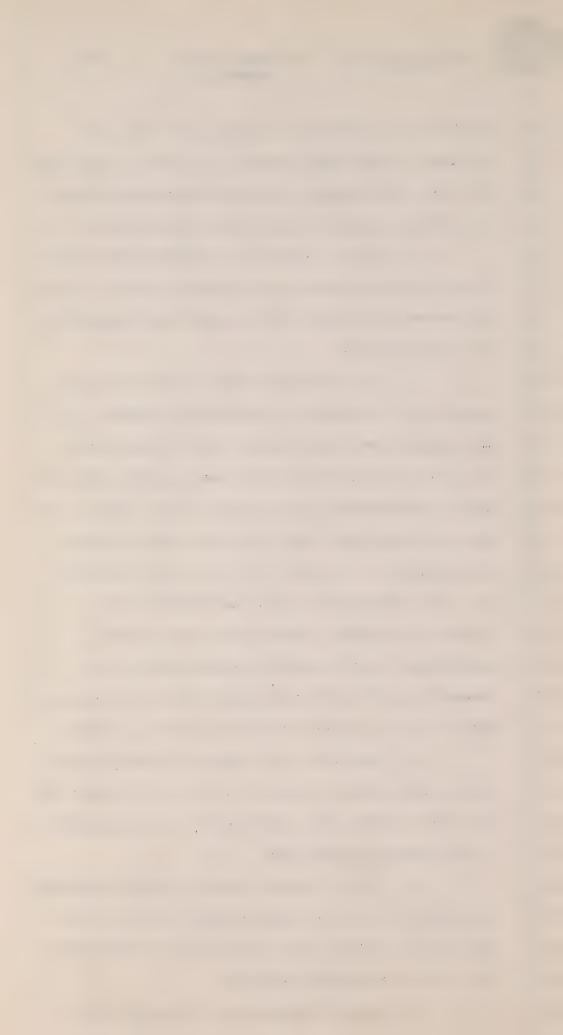
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which we have tradionally applied, and I would be inclined to think that that sort of a test is about the best one and certainly the one most thoroughly founded in economic precept that one could find to apply.

- Q. Do you regard as an essential hand maiden to any scheme of maximum rate control a greater element of freedom to the railroads to abandon unremunerative services and lines?
- I do not think that is a necessary precondition to an appropriate maximum rate control. It may, however, well be something that is necessary if one is to succeed in sustaining the railroad system out of its own revenues over a period of time. But at least under the approaches that is the way usually taken to these things. The shipper is, in any event, entitled to a just and reasonable rate, as defined by an appropriate economic standard, and the question whether when that is done the revenue position is adequate to sustain the railroad system, as it certainly must be, is in essence a separate question, I think.
- Q. And then to the extent that the railroad revenue requirements may not be met out of revenues and yet there is still the. maximum rate regulation, where is the deficit to come from?
- A. Well, you see, any such maximum standard as I propose is in the first instance related to what the level of railway costs may be, and, in consequence, it is itself a shifting standard.

If one were dealing with a situation that



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worked entirely in accord with economic analysis, one ought not to find that such a standard resulted in a deficiency of revenues. But, it is likely to do just that if you have a situation where there are substantial losing services and losing portions of a railway system grafted onto the rest. If you let economics take its course, that pre-supposes if you are willing to dispense with non-compensatory services and with non-compensatory lines to the extent that the economic process is not allowed to work to that degree, then there is the question where are the revenues to come from? In effect, what I am asking here is that the revenues to support those kinds of services that are deemed to be necessary, notwithstanding the inability of revenues to take care of them, ought not to be placed upon the shippers of freight beyond what would be a just and reasonable rate for them. That leaves open a possibility, perhaps, of some form of subsidy, if it is determined that as a matter of public policy that these losing services or lines have to be continued, and I think maybe the answer would be in that direction, if that kind of a decision is reached.

- Q. Would you envisage that a scheme of maximum rate regulation would still carry with it the need for general revenue cases? Or, could it be selfadjusting?
- A. In itself, I do not think it carries any such necessity, but if one were faced with substantial inflationary pressures, it seems to me that with or





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without such a standard the general rate level

proceeding might prove to be a necessity. But I do not

think that it would be affected one way or another by

the standard of reasonableness proposed here. The

standard itself would be an adjusting thing. It would

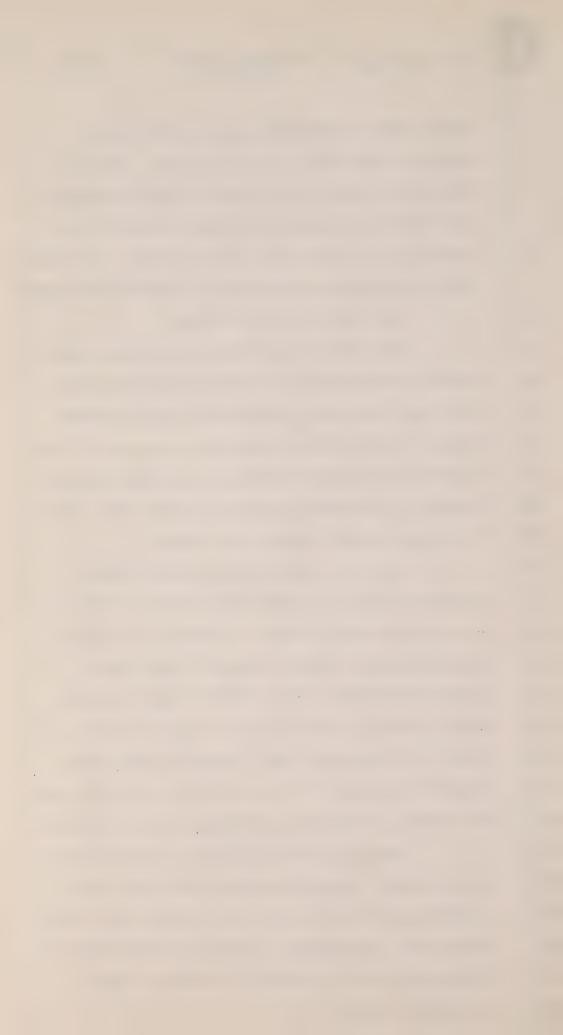
adjust along with an inflationary or deflationary change.

Q. Thank you, Dr. Williams.

There was one point which is perhaps outside the ambit of your brief, but now that you are here I would like your views, if you would care to express them as a transportation economist. Do you see in the foreseeable future any significant development in the movement of commodities generally by air cargo? What is in your view the future of air cargo?

A. Oh, I think in terms of its present situation it has a very brilliant future. We are in the position where it begins to appear that we shall have serviceable aircraft designed to meet cargo requirements within the not distant future and that what we should be able to do in the United States, at least, is to bring the level of our air cargo rates down from something of the order of 18¢ a ton mile, on the average, to something bordering on 12 or 13 cents.

Those ton mile costs apply, however, to air line distance, though they would convert into lower figures comparatively on surface transportation. And, under those circumstances, I would anticipate that air cargo would find it possible to cultivate a quite substantial market.



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This is a market, however, which I think would fall in the category of high grade manufactures and miscellaneous traffic; traffic moving on less carload lots -- perhaps some forwarder traffic, and the like -- and I would think in the United States, at least, the impact of air transportation would be felt more heavily by the trucking companies than it would be felt by railroad companies, partly because we have a large amount of very long haul high grade merchandise moving by truck under our present rate relationship.

THE CHAIRMAN: Because the railways have lost it already.

THE WITNESS: The railways have lost it to trucking companies. We have a trucking company in the West, for instance, that has an average of 1,500 miles in high class merchandise traffic, which is, of course, the opposite of what you would expect, given the economic characteristics of rate making in relationship to railroading.

We have a situation where the Rock Island railroad in the West, for example, in its entire territory find the average haul of its motor truck produce to be 600 miles, while the haul on the railroad is something less than 300.

Now, I think that that traffic is likely
to prove rather vulnerable -- some of it, traffic
transcontinental in character, moving from Chicago to
the mid-west to the Pacific Seaboard and from Chicago
and the mid-west to the east itself, and I would be





## ANGUS. STONEHOUSE & CO. LTD. Williams, cr.ex. (Cumming)

inclined to think the impact on the trucks is going to be rather more severe, particularly in the area where they have extended far beyond their normal economic sphere.

But when all is said and done, this brilliant future for air cargo is brilliant in terms of what air cargo has been in the past, and it does not mean that I expect to see tremendous transfers of ton mileage into the air, because the bulk of our freight transportation is, after all, a short enough haul, and the bulk of it, also, falls in categories of goods that are low enough valued to stand rates, even at the perspective levels.

MR. CUMMING: That is all I have, Mr. Chairman.

COMMISSIONER MANN: On that point, Dr.

Williams, you mentioned earlier in answer to a question

by Mr. Cumming -- you said the impact of air cargo

development will be primarily felt by the trucking

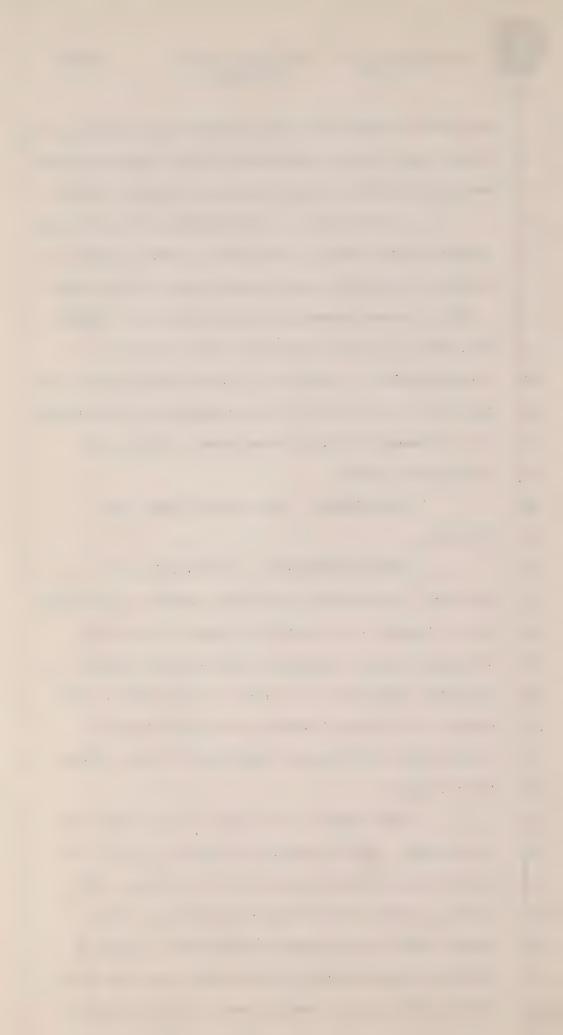
industry. Would you go so far as to say that to the

extent the trucking industry uses piggy-back over

medium and long distances that effect will be felt by

the railways?

THE WITNESS: Well, yes, to the extent that is the case. If the traffic is diverted, it will be a diversion, at least in part, from railroads. Of course, at the present time, we are moving in the United States under piggy-back services a volume of traffic in carloadings that represent less than 2% of weekly carloadings. Some of that is traffic moving





under plan 1, entirely under the control of railroads, so that the impact would hardly be substantial. If we had a major diversion all over the road, common carrier truck transportation, to a piggy-back form of service, than the impact would certainly be felt on the railroads.

THE CHAIRMAN: Mr. Brazier?

## CROSS-EXAMINATION BY MR. BRAZIER:

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Q. Dr. Williams, in several places in your brief you quote from the Rationale of Federal Transportation policy of April, 1960. Has that document been published? Is it available?

A. It was published by the Department of Commerce. It was published not as a document having the approval of the department, but as a document over my signature and that of David Bluestone, my assistant director.

Q. It is not referred to, I note, in the bibliography of reports.

A. No, I think the report you have is the report of the secretary which was issued earlier and, although it was the intention at that time to issue the thing which we ultimately called the Rationale, it had not been issued at the time that original report was put out.

It was designed to provide some rather more detailed explanation on the direction of our thinking than was in the report itself.



Q. Now, Dr. Williams, I would just like to ask you a few questions, maybe more in explanation of parts of your brief, and I start first on page 23, at the bottom of the page where you say:

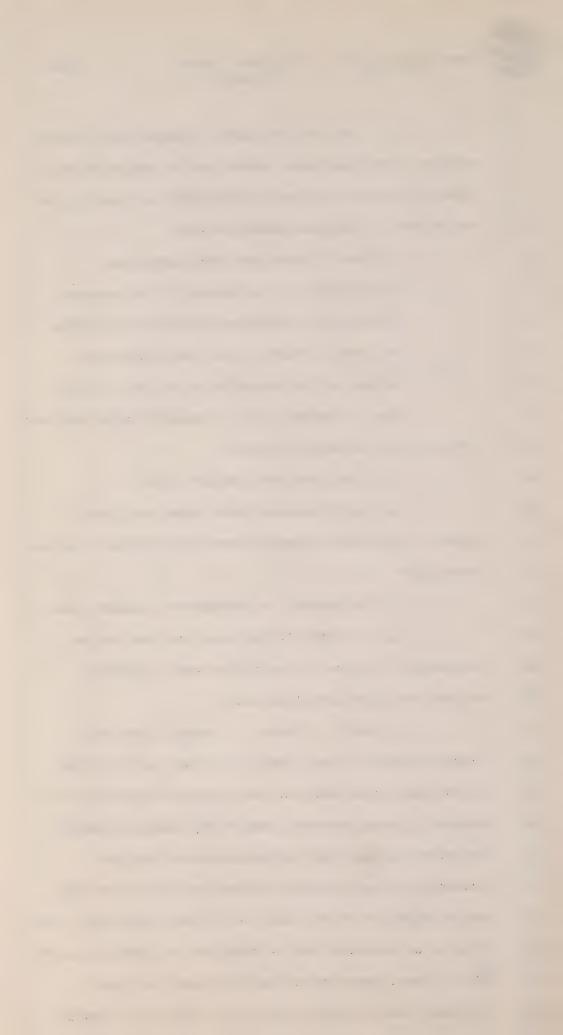
"Although there has been increasing recognition of the necessity for sweeping changes in rate structure by United States railroads, there is not broad agreement either on the necessities or upon method".

Now, I suppose that is recognition by railway

A. Yes, that was the intention.

officials in the United States?

- Q. And I presume that there have been a number of different proposals made by different railway officials?
  - A. Oh, quite. A considerable number, yes.
- Q. I wonder if you would outline to the Commission just one or two of the more important suggestions that have been made?
- important and the one likely to be the most fruitful is the operation that has been carried forward and is currently being carried along by the Eastern Traffic Executive Association, although we have smaller research groups established under the respective rate making agencies in the west and in the south-west, also. This is an approach that is designed to identify, in the first place, areas where the railroads have lost business very severely, and to try, then, to identify



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slow partly because the chief executives of the

through market research what the reasons are for the loss, what the volume of potential traffic may be, and what it may take in respect both of rates and services to recapture a substantial share of that traffic.

They have proceeded on the whole by identifying first commodities which the railroads in the eastern districts appear to have lost almost entirely. And they face the difficulty, of course. that since we do not have any commodity statistics which show the movement of commodities by all forms of transportation, but have that only for railroads and for class 1 regulated motor carriers, they do not know what the total volume of business is that might be moving by. in some cases, exempt carriage, but in almost all cases, by private carriage or by carriers not reporting in the motor carrier statistics. So that they have resorted to the Bureau of the Census as a means of conducting sample studies of the total market as an approach to market research so that they may see what the potential may be.

They have then proceeded to apply a cost analysis and to supplement what they may find through a census sample survey with a considerable range of discretion with shippers, designed to disclose what the possibilities are under various rate or service arrangements, or combinations, of securing some of that traffic which has been lost.

This is admittedly a slow process. It is



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eastern railroads have not in all cases been sympathetic with this attack. It is slow partly because some of the chief traffic officers have not been fully in support, although others have been more or less enthusiastic. It is slow also because there are very great difficulties in meshing in a common undertaking economists and statisticians who have their own jargon and traffic officers of long experience in the making of rates, who also have their own field and their experience behind them, and making the two understand one another so it is possible to go forward to a constructive result.



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I think they have been making a degree of progress and what 'ney did in the Paint Case is an example of the technique which they are trying to apply. This is a situation in which they were dealing with traffic which they had almost wholly lost and as to which they did not know how it was to be distributed with respect to destinations. It was all right, perhaps, as to the origins but not the destinations. They took the territorial average cost by the Form A as their standard and they successfully carried on rather sharp adjustments through the Commission basing it on a showing of what their additional net revenue would be if they succeeded in recapturing the volume of traffic which they estimated from their shippers' survey they could handle. What is distressing is in cases the same as the Paint Case, so far as I could find out a few weeks ago, nobody has taken the trouble to cast off the figures, although they are available, as to what has actually happened in the recovery of the traffic except a proof check on one of the reroutes. This is one of the difficult things in studying rail rates because you have a big arm before a regulatory proceeding and it is asked such and such and now the whole thing will disappear behind a shadow and you do not know what happens. Here, I think, they will cast it up because it is a matter of great interest to them to know whether the thing came out as expected. Undoubtedly the success or lack of it in the Paint adjustment will have an effect on



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whether they come with other adjustments.

- Q. You have been speaking, I presume, of reconsideration of rates which are subject to competition?
  - A. Oh, yes, quite so.
- Q. What, if any, consideration is being given to rates which are not subject to competition or do you have such rates in the United States?
- Well, yes, I suspect we have some rates of that character. Certainly we have the situation where there are a good many small points especially in the west, which although certainly there are truck lines authorized to serve on applicable rates, it is virtually impossible to get surveys out of the truck lines. Secondly, such competition as there is is not very effective competition from their point of view. We have certain classes of traffic that are still more or less railbound. For instance, we do not as a rule move bituminous coal from beyond one hundred miles by truck, and where we haul through available transportation. Therefore, this is essentially a rail movement and there is no economical substitute for the rail movement. Again, in the movement of iron ore away from the lake and away from the inland waterway there is no substitute at the present time for the railroad. We have in respect of that kind of traffic precisely the same problem that I have been dealing with here as to what might be a measure of reasonableness in the light of



the important structural changes in the composition

that have resulted from our rate adjustments. We

I know that if a shipper feels he is faced with an

Section 1 of Part I and seek redress essentially by

Comparison of other rates?

traditional method of the railways. We are getting to

the point where shippers are in a position to put in

evidence, also data on the cost of service, because

they can use for the purpose of confirmation costs

at the time from the economists' publications. That

A. Yes, comparisons on other rates, the

unreasonable rate he can file a complaint under

of traffi and the alteration in the rate relationships

do not have anything in particular at the present time.

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the method of comparisons.

Q.

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is, I suspect, of some effort to them because it changes a little bit the position with respect to the burden of proof because it makes it necessary for the railway to say that these costs are not reasonable in the case.

Q. In the United States is there a reluctance among the railways to discuss their costs in transportation before the ICC?

it took quite a while for that reluctance to break

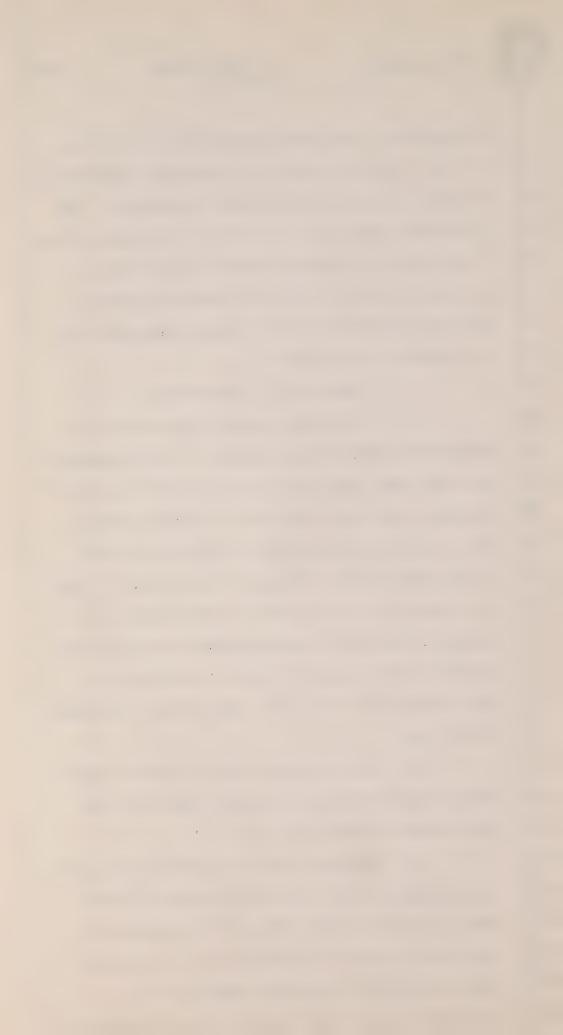
down. I think it broke down out of a realization

where we required an important segment of our

that in our competitive situation and in a situation

motor carriers and water carriers, some of them, by no

A. There was for a long period of time and



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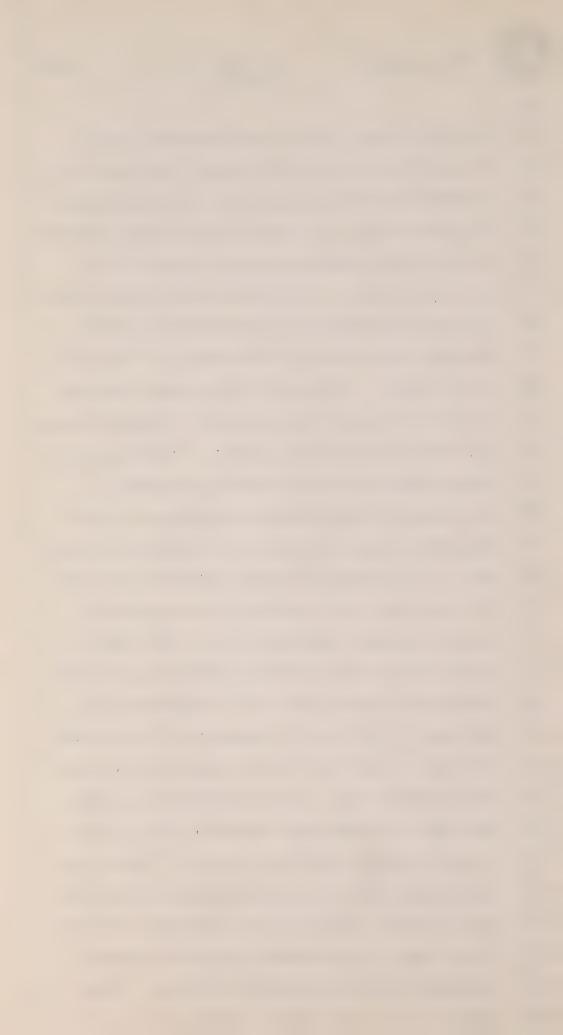
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means all of them, and in view of the way in which regulator proceedings were trending there was no alternative to that use of costs ... In a wide variety of cases they had to do that to sustain their position. In short, the Commission gradually began to insist if it was to deal with a going situation between forms of transportation they must have economic evidence. Certainly cost data are of the essence in a situation of that kind. I think the carriers were certainly reluctant to come to that conclusion. However, having gone that far an increasing number of them have now become aware of the problem and of the possible application of cost finding techniques to the better management of their own business and their rate making If they want to propose rates that are good for them in the first place they have to have cost analyses in their organization and if they want to justify them in the regulatory agencies against their competitors then they must have a defensible cost showing. I find little reluctance to discuss costs and when you talk with railway people about this not a few of them will say, "Well, we missed the boat very badly and are twenty years behind the times," and so on and so forth. There is a schism between the organizations that have been provided as research arms and the traffic officers and the railroads and some times a want of understanding between the research approach and the chief executive officers. These things, I think, have greatly altered.



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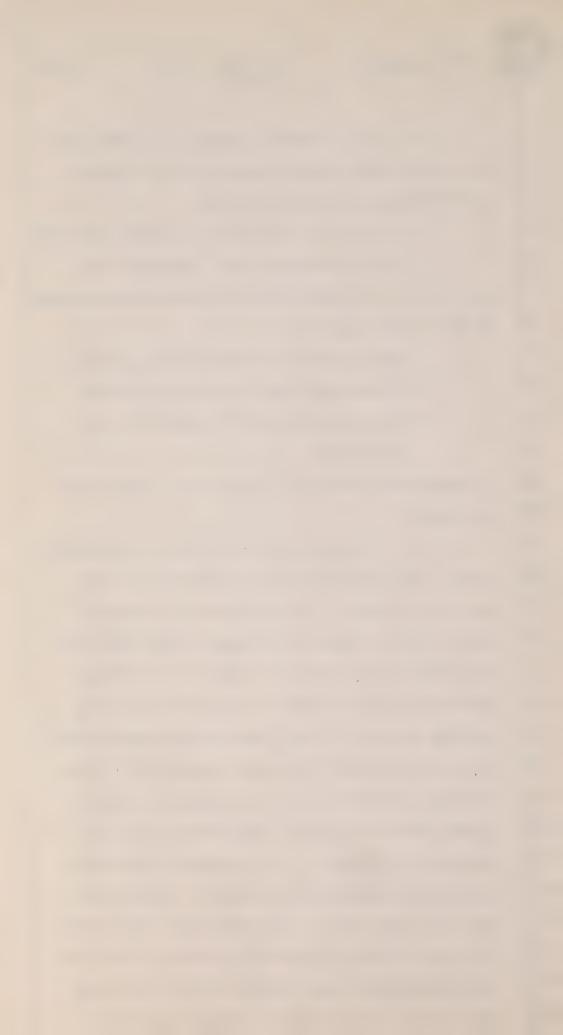
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- Q. So, it would be true to say that there is a trend towards greater emphasis on cost matters in rate making in the United States?
  - A. Yes, I think there is no doubt about that.
- Q. In that regard may I just quote very briefly from the federal transportation policy programme of March 1960, on page 4:

"What is needed is broad general revision of traditional rate structures to bring them more closely into accord with cost structures."

I presume your opinion is that that is a sound policy to follow?

A. I think it is very sound, but unhappily it is a very difficult thing to undertake, as I am sure you well know. In our regulatory situation I think it is not possible that what the railroads are undertaking to do, although I think it moves rather more slowly than it ought to, the wisest course for ultimate results is taking these things piece by piece. As a practical matter the broad revision that I think necessary and would hope for all along the line is a thing which if by some process arrived at by the railroads it is rushed, our Commission would give us a totally indigestible procedure. We might get far more bogged down. Basically what I was talking about was a broad end result in a period of time, but not necessarily a suggestion we should go and scrap what we have and substitute something else almost



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Q. I would presume you would not find among railway people or railway economists anyone who

in a very brief time?

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overnight.

A. I do not think so, certainly not any who have had any close acquaintance with our regulatory procedures or with the carriers' procedures would look for such an overnight structural change.

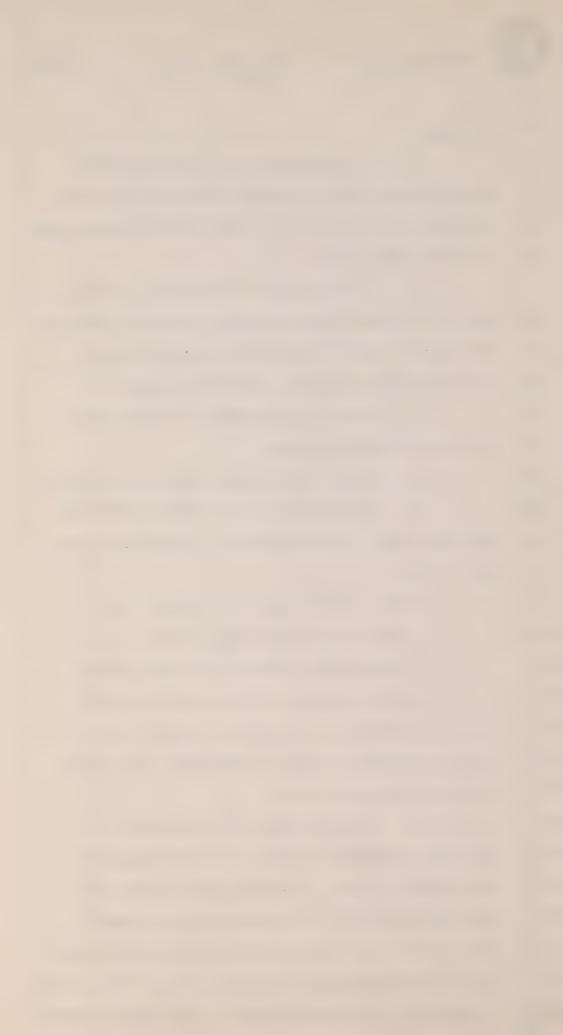
advocates that you could just turn the rate system over

- Q. Would you look more for change over a five-year or ten-year period?
  - A. Well, I think more likely ten than five.
- Q. On page 29 of your brief you made this statement, and I think probably Mr. Cumming mentioned this to you:

"Nor, if the value of the service be said to measure the upper limit of reasonableness, have we ever had abstract tests of value of service which did not involve us in circular reasoning."

You are speaking in terms of justifying a rate being a just and reasonable rate?

A. That is right, and referring to a test that is something other than a comparison with the pattern of rates. We have generally taken the view that the value of the service sets the upper limit of the rate. Our trouble has been that we have had no independent measure of that value of the service. In practical fact we have worked it out largely through



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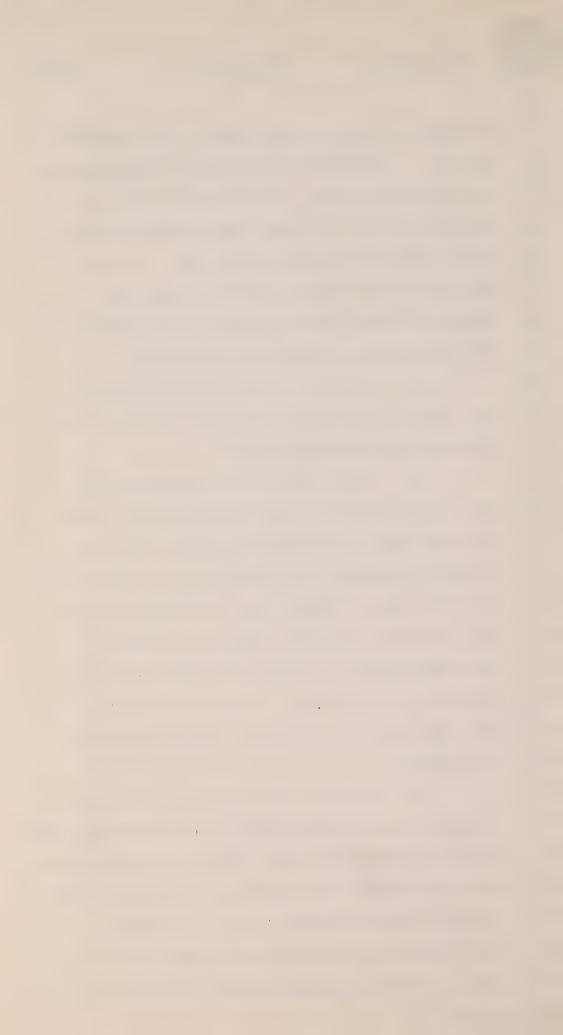
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the medium of comparison and that has been the method applied. A rate may be challenged as being unreasonable from the carriers point of view because we have nothing or little about transportation service with respect to any changes in the rate. If they wanted to have the report before them they must mechanize the whole thing to experiment with what a rate would produce in practical application.

- Q. Would it be your opinion that today's cost factor should be given some consideration in the determination of reasonable rates?
- A. Well, I think they always have been. What is really being so much discussed today, I think, is a shift from value of service to cost, but it is a change of emphasis in the relation of the two. Certainly the kind of standard that I have been talking about and which I think Mr. Roberts will expand considerably upon, is a kind of test that is directly related to a cost standard. This is related to a cost standard; it is not however, strictly speaking a cost standard.
- Q. Going back for a moment to this question of maximum scale of rates which would be the maximum for so-called captive traffic, two ideas, at least two ideas, have been put before this Commission to date, one by the Province of British Columbia, which I represent, suggesting that the maximum scale of rates should be fully allocated costs possibly plus 5 per cent or 10 per cent.



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The other scheme, put forward by the Province of Albert , and undoubtedly you have read it -- Mr. Harries' proposal -- that the maximum scale of rates should be 140 per cent of the lowest competitive rate.

MR. FRAWLEY: Of course my friend understands the 140 per cent was just a figure which Mr. Harries took and he emphasized it must all be subjected to a very close analysis by the Board of Transport Commissioners.

MR. BRAZIER: I think that is true.

MR. SINCLAIR: It happened to be related to ---

MR. FRAWLEY: Mr. Sinclair is talking about Dr. Roberts and Mr. Harries and they are two different independent approaches.

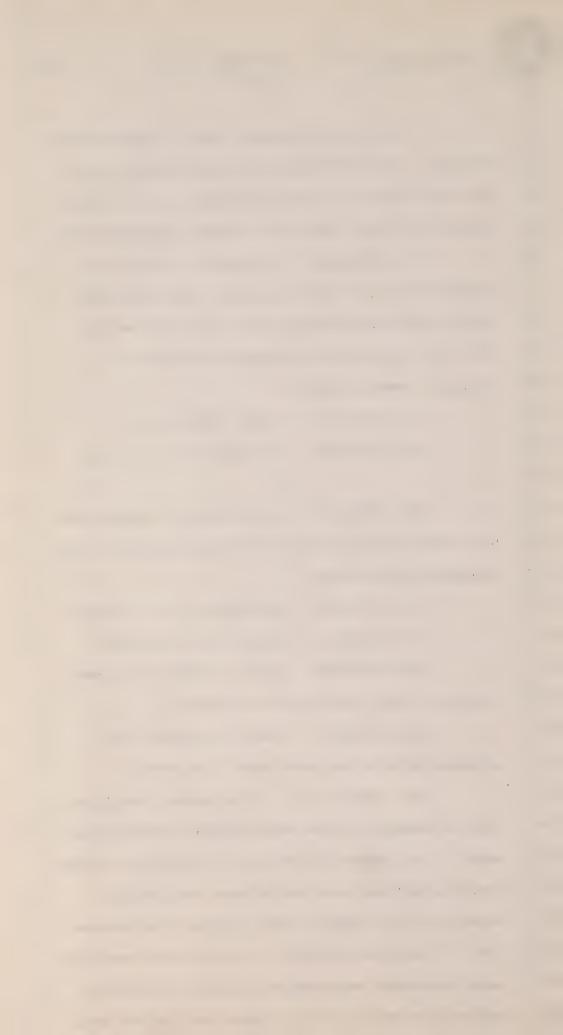
> MR. SINCLAIR: They happen to be the same.

THE WITNESS: Did you pose a question?

THE CHAIRMAN: You have probably read the evidence of Mr. Harries and Mr. Hughes?

THE WITNESS: I have read parts of it although not with any great care, I am afraid.

MR. BRAZIER: Q. Now, doctor, would you care to comment on those two proposals that have been made? As I understand it there is criticism of both proposals and you are a man of very considerable standing in the field of the economics of transportation. I would appreciate -- I am sure the Commission would appreciate receiving any comments you wish to make with respect to both of those, and you may deal



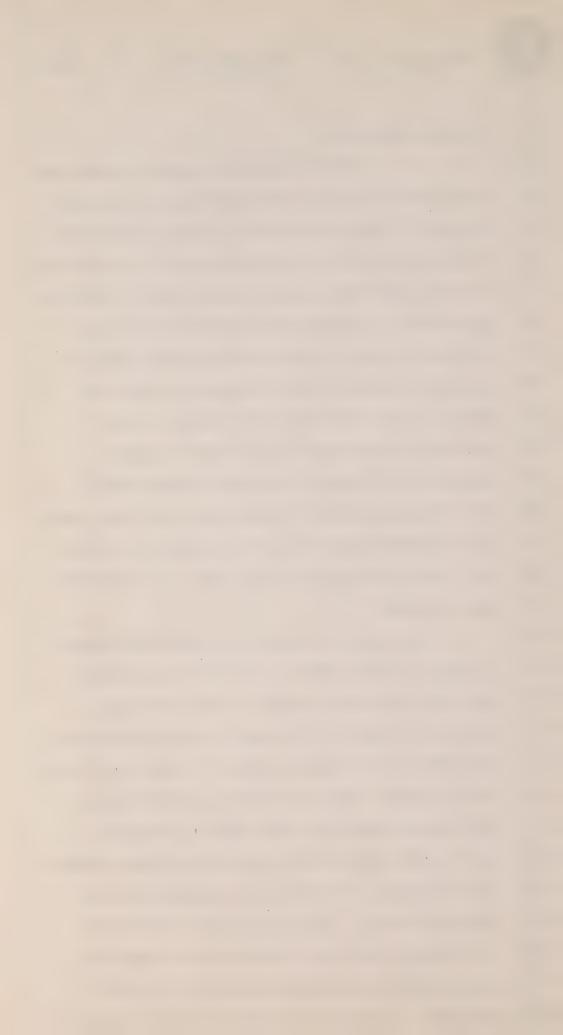
with them separately.

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I would first make a general comment that I think, while it is a rather dangerous and inflexible procedure to adopt, some kind of a maximum structure of rates more or less across the board would seem to me to be more reasonable and more appropriate to establish. in principle; a standard that might be relied upon by those inclined to complain of an alleged unreasonableness in particular rate situations so that the standard could be applied in the context of the particular situation and the necessary judgment exercised by the Board of Transport Commissioners. I do not think this kind of thing lends itself very readily to a methematical formulation, certainly not one that, in my opinion, in any way ought to be introduced into a statute.

Now, quite clearly, any standard that would be related to tests derived from the probable level that rates would have to take, if they were equal rates in the light of the volume of traffic that would come under such a situation would, of course, be a level that lay above a fully distributed cost determined from an historical period with quite a different traffic bevel. It seems to me clear that any standard for maximum reasonable rates is a standard of fully distributed costs. The question of how much above is, it seems to me, not a question we can answer on the basis of such information as we have presently available. Certainly I can answer it on the basis of



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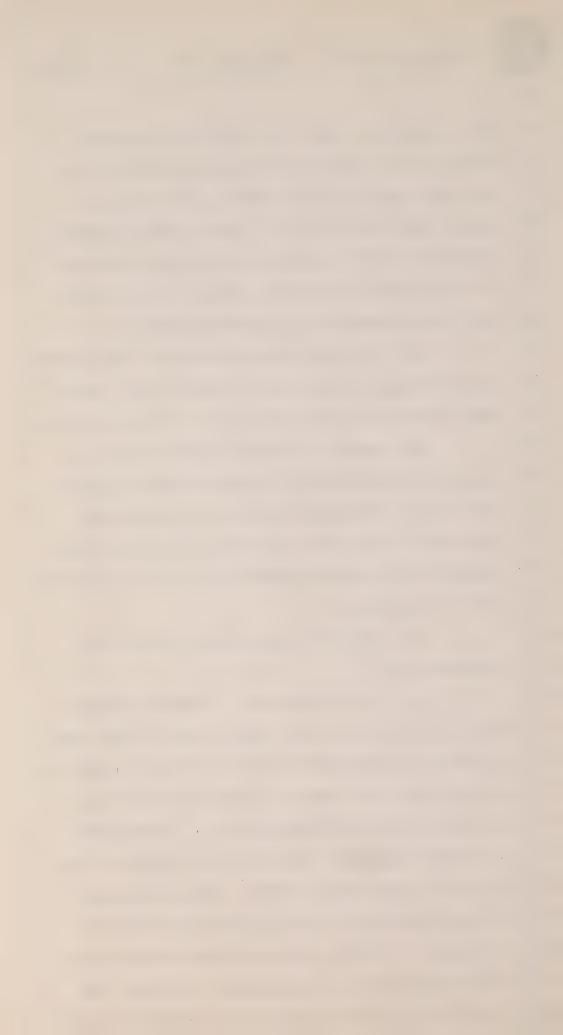
what information I have, but I think it is entirely possible that it might not be greatly different from some such figure as 140 per cent. I do not know whether that would be true. I do not think it can be ascertained without considerable study which certainly I have not made and would not perhaps be able to make from such information as is presently available.

Q. There was one qualification of the British Columbia proposal which I did not mention and I think I should mention it to you and then ask for your comments.

The proposal of British Columbia is that its maximum rate scale would only apply to captive traffic, that so far as competitive traffic is concerned the competition would be the regulator and we would do away with any form of maximum regulation as far as competitive traffic is concerned.

Now, would that qualification change your opinion at all?

A. I do not think so. Generally speaking, even if one is talking about captive traffic only, that is the kind of thing that I would be inclined to want to deal with with some degree of flexibility vested in the Board of Transport Commissioners. I think that is an essential requisite, especially if it should be true that some of your taptive traffic deals in relatively basic raw materials or items in the early stages of processing. This is a case involving marketing problems that are of not inconsiderable consequence and it would not be unwise to apply purely mechanical standdards in determining what pught to be done.



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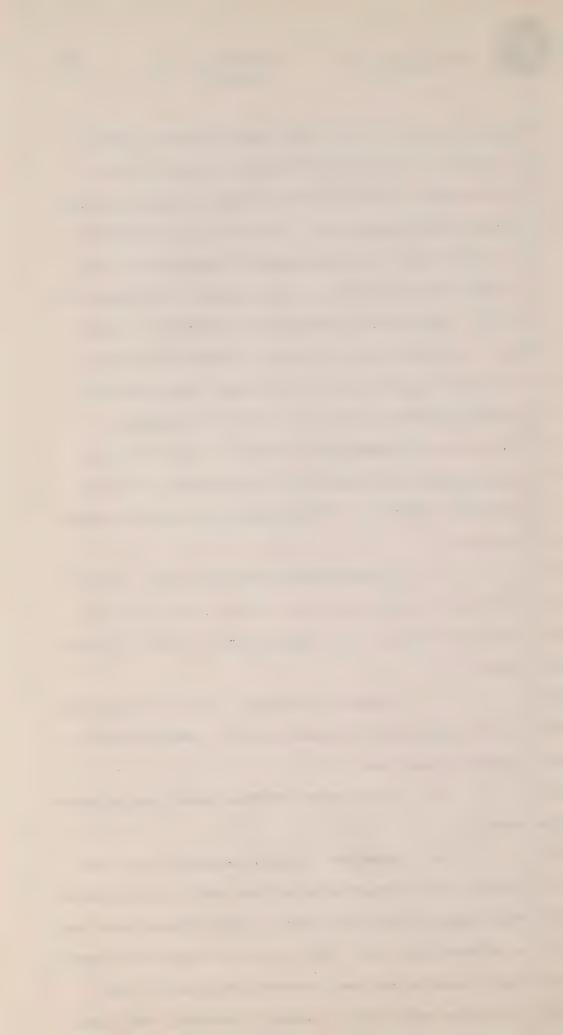
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The notion that such a test would be applied only to captive tra fic is one we worked a little bit with at the time of the cabinet committee on transportation policy and organization. We started out by feeling that in view of the wide range of competition in the United States we didn't require maximum rate control at all. Upon further examination, however, we reached the conclusion there was still a fairly substantial volume of captive traffic as to which some protection would be necessary and, in essence, we proposed a retention of maximum rate control and application on traffic which was shown to be substantially not competitive traffic -- in other words, essentially captive traffic.

- I presume the situation is the same in the States as it is in Canada today, that your class rates are actually your maximum scale of rates; is that true?
- Generally speaking. It is very rare and a most exceptional circumstance for a commodity rate to exceed a class rate.
- Q. . Do you have instances where they do exceed them?
- Some few. But, as a general rule even though on an interpretation of the tariff it might show the commodity rate would have to apply because there was no alternating rule, there would be a prima facie case that commodity rate was unreasonable because it did exceed the class rate. Generally speaking, the class



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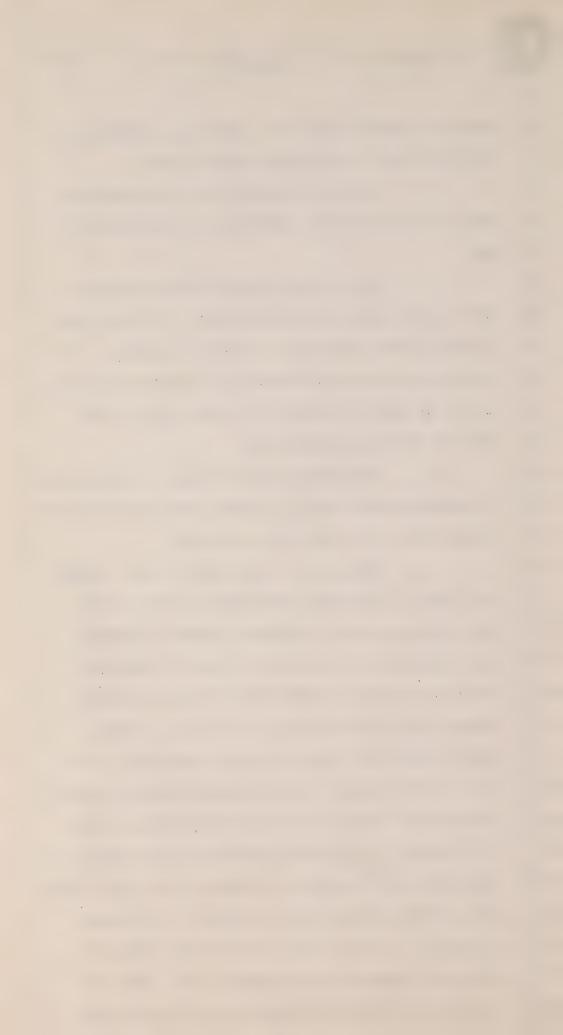
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rates are maximum rates and a good part of them have been prescribed as reasonable maximum rates.

- Q. Would you agreed with the proposition that in effect the class rates are an arbitrary maximum?
- Well, they certainly are in practical effect pretty much a maximum with us. I am not sure I like the word "arbitrary" as applied to them. Certainly they were not determined in an arbitrary fashion, if that is what you meant; but, rather, after quite long and careful consideration.
- Q. Were they evolved through the old process of determining the value of service rather than the new concept which you suggest in your brief?
- A. Well, it is very hard to know really scales of rates are established so far as they are prescribed by the Interstate Commerce Commission. The Commission would probably say that it never prescribed any rates in connection with which it didn't consider both cost and value of service. In the case of prescribing class rates one would find in the report some discussion both of costing factors bearing on the matter and of value of service factors bearing on the matter. It is quite commonly a case, however, that most of the attention is focused on the first class rates and that there is not a showing of costs cast up against the whole range of class rates that are presented, because when we prescribe the class 100 scale we are prescribing a whole nest of scales some



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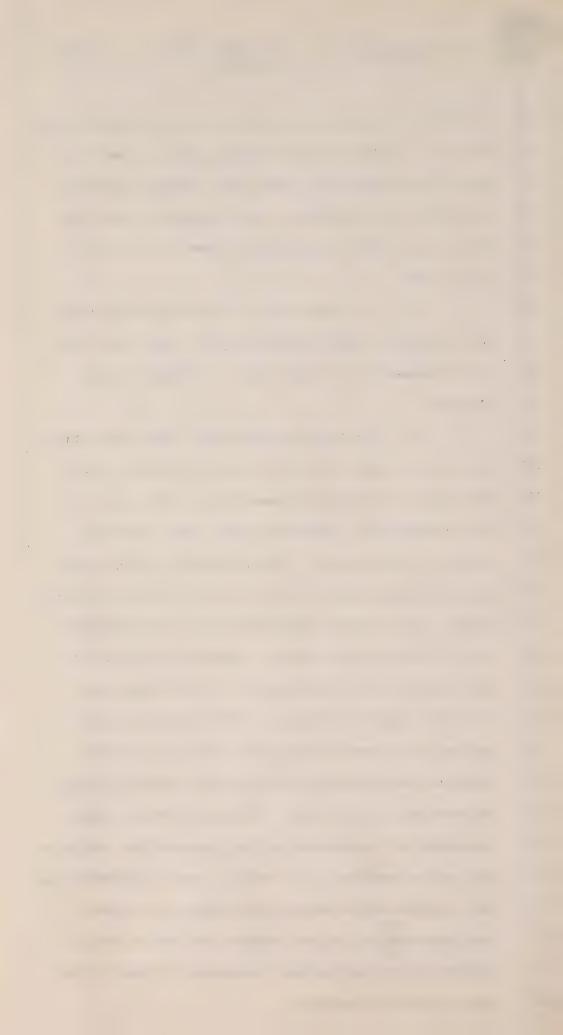
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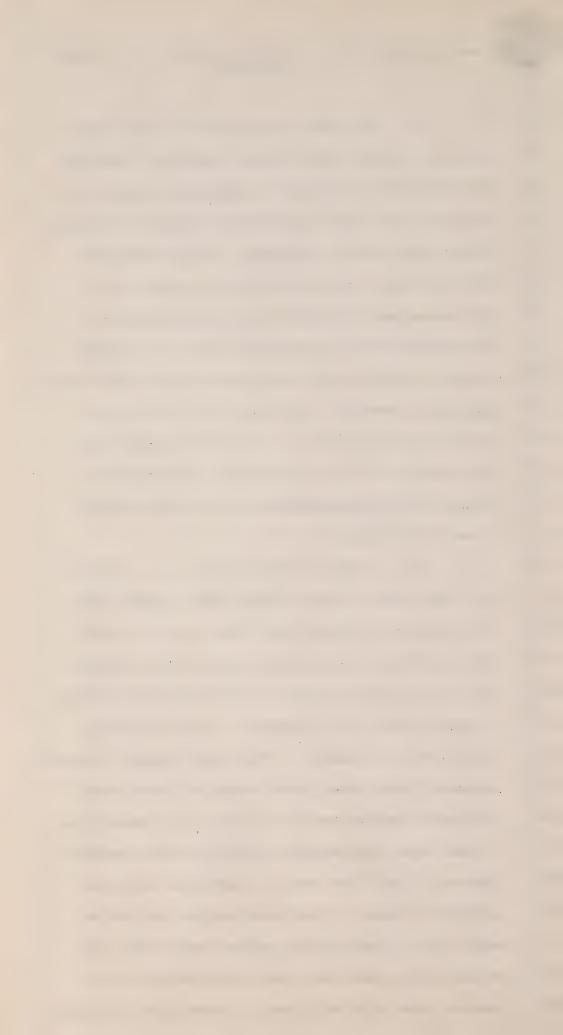
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of which quite commonly go down to 172 per cent or even less of the class 100, and nothing would be said in these proceedings about that issue, neither are they generally tested against a cost standard -- have not been in class rate proceedings in the United States. at any rate.

- Q. You said some of them had reference to cost figures in their determination: were they true cost figures or were they based on average revenue figures?
- Q. In the prescription of class rate scales, so far as I recall, prior to docket 28300 the class rate scale of 1939, there was never a cost study as such presented in connection with a case involving scales of class rates. The discussion on the scales of class rates would run in the older and more general terms, as to general understandings of the relationship of costs and the various lengths of haul as to what the cost function would be over the ranges of all that would be involved. The assumption would be that the classification took care of the differences in cost factors related to the commodity itself, and that was not in issue. In many of those cases, the matter of revenue was not in issue either, and such test as was applied, by a traffic test or otherwise, to the proposed scales usually was nothing more than a test designed to disclose whether the scales about to be prescribed would produce equivalent revenue to the rates hitherto in effect.



- Q. You have some reference in your brief to class. fication: the bottom of page 35, "The value of the service by railroad is coming more and more to be fixed by the cost of performing a substitute service by some other form of transport. Many of the traditional classification principles are deprived of their accustomed usefulness in circumstances such as these and this is especially true of such weight as might ordinarily have been given to the value of the commodity in seekings its proper position among the classification ratings." Is it your opinion that this revision of the rate structure also requires a revision and a reconsideration of the classification in the United States?
- had a study made by one railroad which suggests that out of some ten thousand items which we show in the uniform classification on the lines of that company and, a fairly large company only about one thousand of those items could be picked up as representing actual traffic movements. This would suggest that the problem of paper rates, rates which no longer move any traffic because the traffic has gone elsewhere, or in some cases the commodity may have become obsolete although, I think the case of competition diversion is the most common this would suggest we have an awful lot of classification ratings which when taken in conjunction with the class rate structure do not produce rates which will move in competition with some



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other form.

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COMMISSIONER MANN: Aren't some of your commodity rates geared to classification ratings?

THE WITNESS: They are. They are sometimes published as percentages of the Class 1 rate. In other instances we have somewhat slightly different scales prescribed for commodities, but a good many of them are tied to the class rate scale.

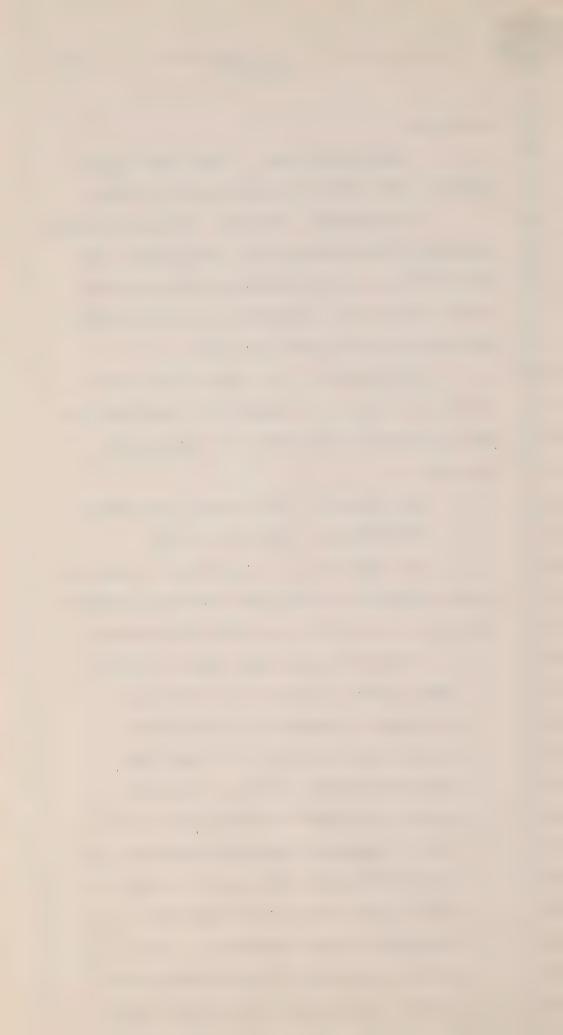
MR. BRAZIER: Q. I would like to make reference to your book Regulation of Motor-Rail Competition, which was published in -- was it 1951 originally ---

MR. FRAWLEY: 1958, we said this morning.

THE WITNESS: Published in 1958.

MR. BRAZIER: Q. In your book on page 162 you make reference to the unique New England Classification, and I wonder if I could read that passage:

"Though the unique New England classification might be subject to reaction it was generally supported by the shippers and was adopted as a basis for the class rates prescribed as minima. In general, shippers expressed the belief that it was only by adoption of the density principle in classification that they could be assured of enjoying the benefit of the 'inherent advantages' of motor transport. The Division found that 'from the standpoint of abstract reason there can be little doubt



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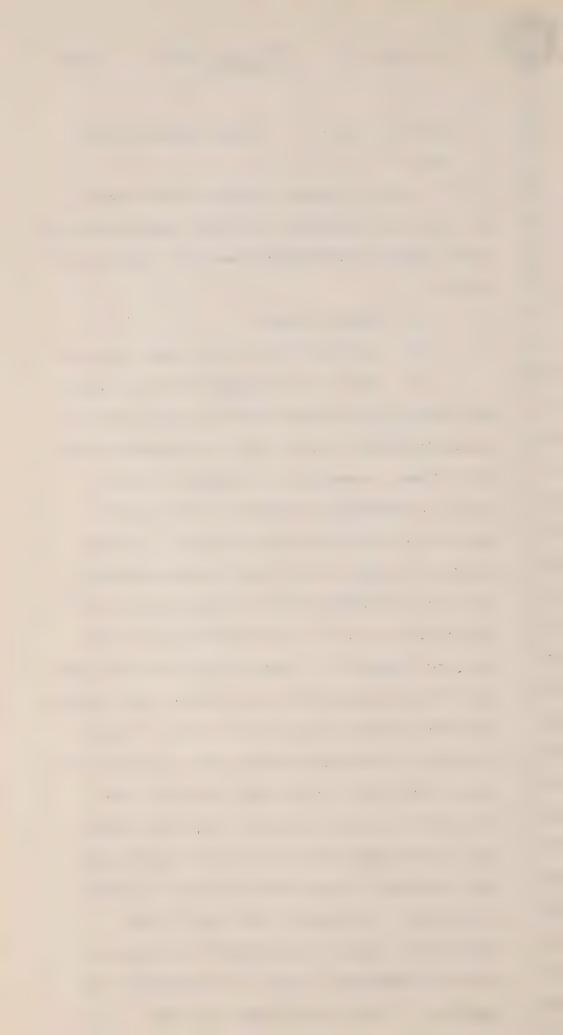
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that the theory . . . is the sounder of the two. "

First, I wonder if you would describe to us -- and, in my reading of this, the classification is a motor carrier classification and not a rail classification?

- A. That is right.
- Q. Would you tell us its unique features?
- Well, its principal feature of uniqueness was that the carriers chose to classify their commodities almost solely in the first instance on the basis of what is referred to as density; that is, simply the relationship between the cubic space occupied in the vehicle and the weight. So that, you might say the test they used was the weight per cubic foot, observing that the transportation unit -and this is true of all transportation units -- has really two dimensions of capacity: one the cubic space that it can encompass within the vehicle, and, secondly, the weight lifting ability which it had. That is on the whole a somewhat more important thing to a motor carrier than it is to a railroad because at least until size and weight limits are liberalized further they do suffer from the problem of getting adequate cubic dimensions to deal with some kinds of traffic effectively. Accordingly, they would in that classification express the ratings to be assigned to different commodities in terms of the density of the That is the weight-cube ratio. In commodity.



and if we can get a set of ratios that are compatible, what we come out with is that no matter what commodity or combination of commodities we load, if we load them that way, and do not exceed its weight-carrying limit, on any such combination we will have approximately the same vehicle mile revenue when this classification is applied."

In the first place, it is a quite simple approach, and it makes — it is obviously a rather intriguing approach. It resulted in the New England case, however, in lots of trouble, because other parts of the country did not adopt that form in the motor industry, nor were the railways using it, and so it became necessary to publish a more than usual number of competitive rates in order to meet railroad rates derived from a classification based on different principles.

- Q. The classification then, in fact, ignored the value of the commodities?
- A. They did, with very minor exceptions.

  Of course, they necessarily had to bear in mind they

  did have a risk as an insurer. The value of the

  commodity is a measure, certainly, of the risk the

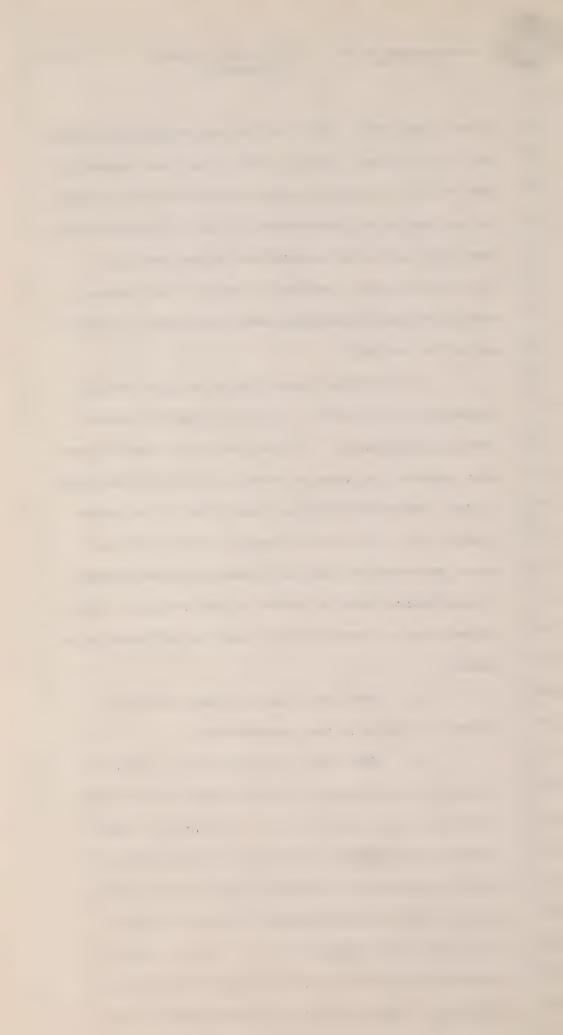
  carrier assumes as an insurer, and from that point of

  view the value of the commodity really relates to

  that particular element. So, it would be

  necessary to graft on a pure classification factor

  some way in taking care of the high risks of the



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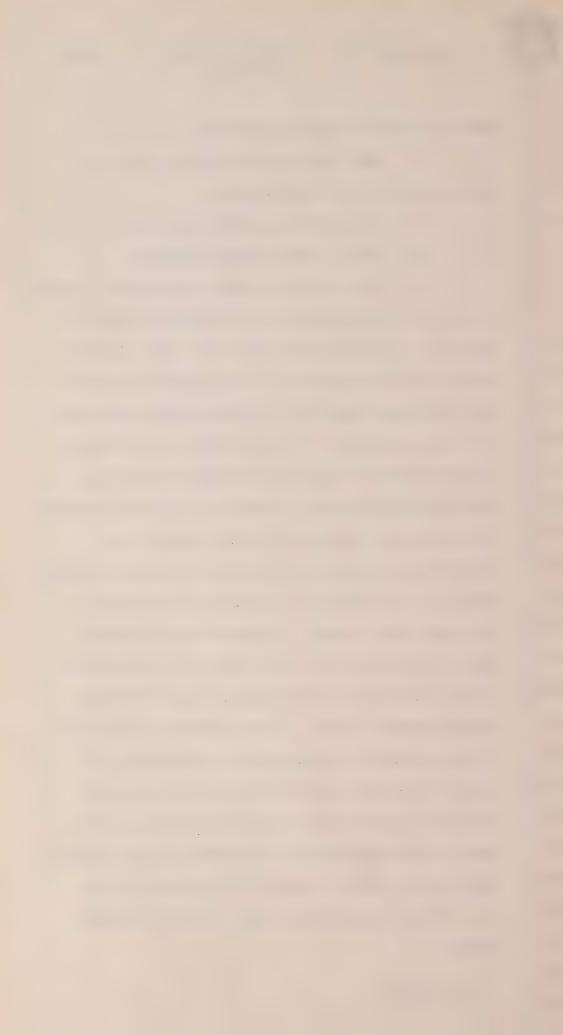
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unusually highly valuable commodities.

- Q. Was that classification allowed to go into effect in the United States?
  - A. Yes, and it is still in effect.
  - Q. Has it been adopted elsewhere?
- Not to my knowledge in the United States. It is still a peculiarity of the New England motor carriers. Generally elsewhere they use a classification that is very similar to the railroad classification and they adjust their classification ratings on very like principles. You can read the discussion of the business of classifying freight produced by their classification man, and you can probably transfer it in almost all respects over into similar work written from the point of view of the railroad classifi-It is similar, of course, in principle to several other things. Elsewhere, for instance, this is essentially the same thing as the loadability concept which the British railways adopted in their maximum charges scheme. It also bears a relationship to the practices of ocean carriers in dealing with general cargo rates where instead of developing an elaborate classification of commodities they use the method of quoting weight or measurement, ship's option, which enables them to charge for a measurement ton or a weight ton depending on the density of the commodity.

<sup>---</sup>Adjournment.



# ROYAL COMMISSION

ON

## TRANSPORTATION

HEARINGS

HELD: AT

OTTAWA

VOLUME No.: **102** 

18 Oct. 1960

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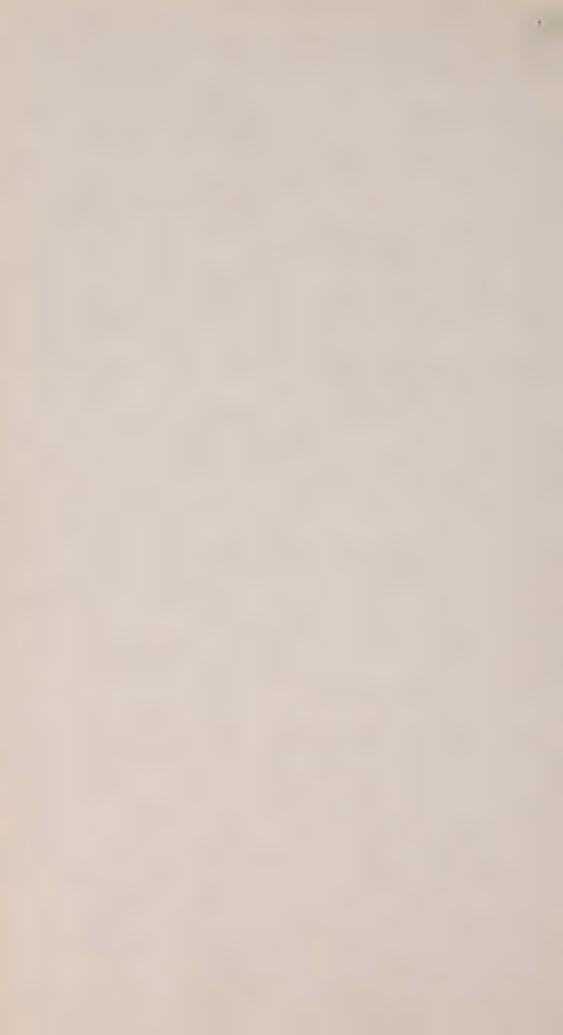
Cross-examination

By Mr. Brazier (resumed) By Mr. Sinclair

By The Commission By Mr: Anscomb

> By Mr. Mann By Mr. Platt

NO EXHIBITS IN THIS VOLUME



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ROYAL COMMISSION ON TRANSPORTATION

Proceedings of hearings held in the Court Room, Board of Transport Commissioners Offices, Ottawa, Ontario, on the 18th day of October, 1960.

#### COMMISSION

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Chairman

Mr. H. Anscomb Member

Mr. A.H. Balch Member

Mr. R. Gobeil

Member

Mr. H. A. Mann

Mann

Mr. A. Platt Member

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Adviser

Mr. F. W. Anderson

Secretary

Major N. Lafrance

Assistant Secretary

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Ottawa, Ontario, Tuesday, October 18, 1960.

--- On commencing at 10:00 a.m.

THE CHAIRMAN: Order, please.

MR. COOPER: Mr. Chairman, I have a letter from Mr. Rand Matheson, General Manager of traffic at the Dominion Steel and Coal Corporation, Limited, which I should like to put on the record. It concerns questions raised during the course of Mr. Matheson's examination by Mr. McDonald of the Canadian National Railways.

Mr. McDonald put the following question to Mr. Matheson:

"Q. On the basis of your shipments for 1959, how much would it cost the treasury if your suggestion were adopted?"

And answers and further question were as follows:

"A. MR. MATHESON: I haven't worked that out.

"Q. I think that might be of interest to the

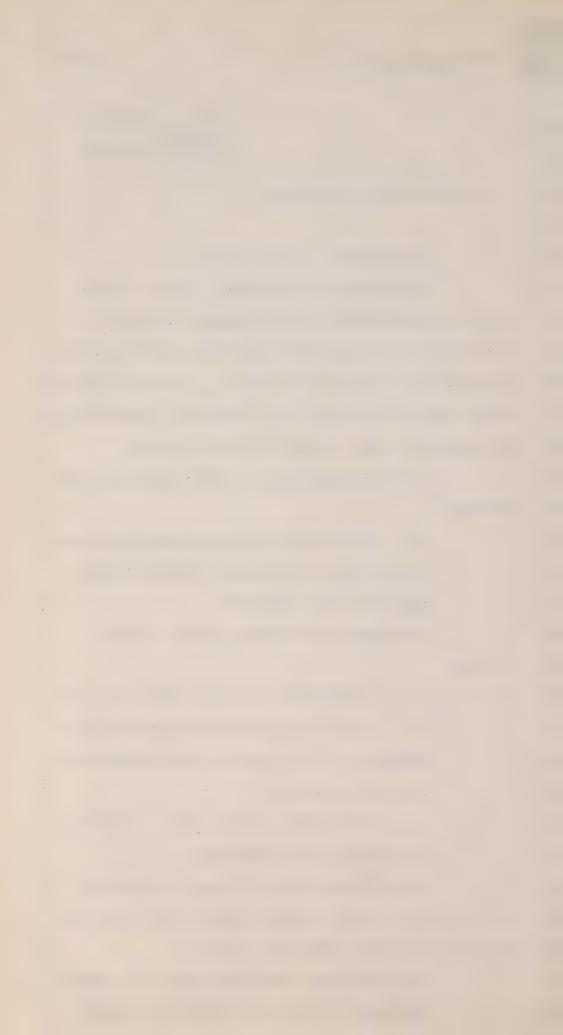
Commission. Could you work that out and give

it to the Commission?

"A. MR. MATHESON: We will make an estimate and give it to the Commission."

The information is as follows, as contained in this letter from Mr. Matheson, dated October 5, 1960, and I quote from Mr. Matheson's letter:

"The additional assistance under our proposal predicated on the 1959 volume of shipments



originating at the Sydneys, Trenton, N.S. and aint John, N.B. (exclusive of coal) would amount to approximately \$1,066,000.00.

"Is is to be appreciated in this connection that the amount of payment would vary upwards and downwards contingent upon business conditions, etc."

That is the end of the quotation and the letter.

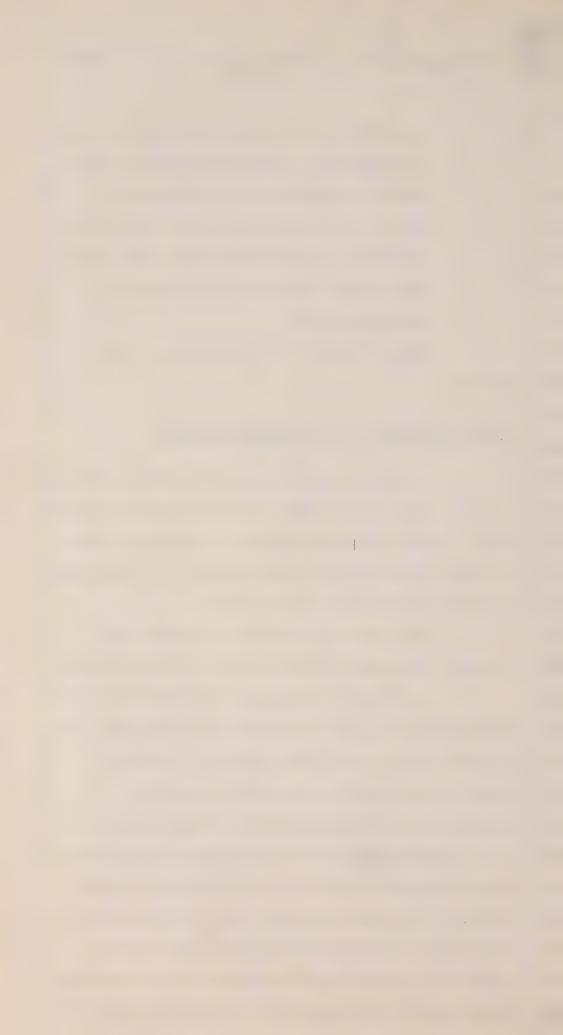
### CROSS-EXAMINATION BY MR. BRAZIER (resumed)

Q. Just a few more questions for Dr. Williams.

Dr. Williams, will you turn to page 35 of your
brief? In the paragraph starting in the middle there,
you make reference in the first sentence to "the economic
advantages of the railroad technology".

Would you tell me what you consider the economic advantages are that you are speaking of there?

A. Well, by comparison with other forms of transportation I think those advantages would fall into two main heads. One is the economy of line haul transportation which the railroad is capable of achieving and exceeds, generally speaking, any form of inland transportation that we have with the exception of water transportation where we have available natural waterway conditions that make it possible for effective large scale navigation to be provided at a limited amount of expense. In the improvement of the waterway itself and with the exception of relatively large



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diameter pipelines, the railroads' economy is very largely to be found in the line haul operation, and it is naturally enhanced when the railroad has available for handling large volumes of traffic and is capable of giving full effect to that line haul economy through movement in quite heavy train loads.

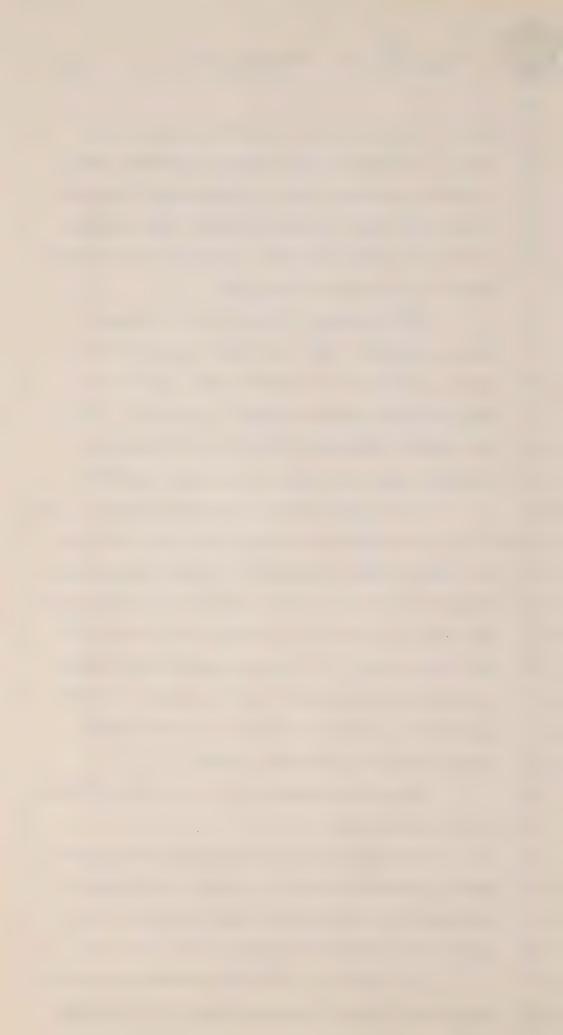
The railroad, of course, in the ordinary situation achieves those line hauls economies at the expense of considerable terminal costs. And in the handling of many types of traffic in terminals, it is a less flexible instrument as well as a more expensive instrument than, for example, a trucking operation.

On the other hand, a trucking operation is one 15 which is characteristicly encumbered with very heavy line haul costs so that, although the terminal expenses may be lighter than rail expenses, under many circumstances their line haul costs will multiply very rapidly with the length of haul. So, often at comparatively short lengths of hauls, it becomes more economical to effect a movement by railroad, if there is a volume that permits reasonably good train loading.

The second advantage of the railroad, I think, is its adaptability.

Water transportation, in many instances, and pipeline transportation are much more specialized instruments that are generally most adaptable to the movement of certain bulk commodities in large lots.

Our success in using water transportation for the package movement of general cargoes in competition



with a railroad system on the whole has not been very satisfact; y, although it is conceivable that in some applications we may make it so by the use of containerization. But I think it is the wide range of capability in the railroad that I would put as its second large advantage.

- Q. Would it be your opinion, Dr. Williams, that the new railroad technology has made the distance factor less important so far as costs are concerned?
- A. I think that is probably true, in some degree, if we are talking about the costs of point to point movement, inclusive of terminal costs, because its application to the present time, at least, has had its impact primarily on the line haul, and I would think the overall effect, if one were capable of studying that in full, would be as you suggest.
- Q. Now, on the following page of your brief, page 36, you use the phrase "mechanical adherence to a cost standard".

I wonder if you would mind explaining what you have in mind in the use of that phrase?

A. Well, I used the term "mechanical" perhaps in the sense of what one might call alternative; not in the way of a slavish adherence. I think that in fact any cost scales that we are likely to develop have the demerit that they cannot possibly represent the variety of circumstances that are occasioned in connection with particular hauls; and that it is the better course, certainly, unless a scale, let us say, of maximum rates



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were high enough in relationship to the cost structure to allow g eat latitude for adjustment below it, to permit of considerable deviation in detail where it could be shown that particular circumstances differed from those that might be assumed in any such scale construction.

What I am arguing for is that a little more flexibility is required then to take perhaps a cost function and graph it and then apply it without variation.

- Q. But you think greater emphasis on the cost factor is advisable?
- A. I think it is not only advisable but if we are to secure good economic results, quite patently necessary.
  - Q. On page 37, under "A" there, you state: "That carriers will put in force or continued force no rates which lie below the appropriate cost."

Would you explain what you mean by "the appropriate cost" there?

A. Yes, I think that this is one of those situations which gives everybody a great deal of difficulty as to what the level of cost is that ought to be applied. This really has been a most controversial element in our rather wide range discussions of the subject over the last five or six years in the United States. There, however, mostly because of the competition among types of transportation within the regulated structure.





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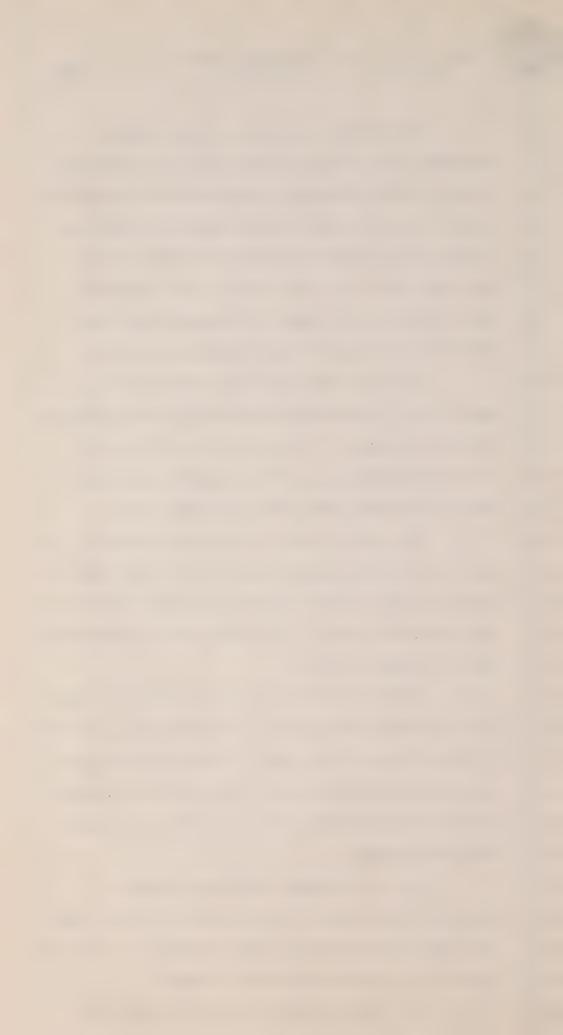
My feeling about that would be that an appropriat cost, when a new rate is to be established. looking towards a movement of traffic that is presently handled by railroad, or looking toward the recapture. perhaps, of a substantial amount of traffic that has been lost, would be a cost that had been calculated with reference to the expected increase in the cost structure resulting from that addition of traffic.

Now, if, however, we have occassioned test rates already in existence on presently moving traffic, we would fall back, I think, on what we like to call in transportation circles "out-of-pocket costs", but what the economist would term a "marginal cost".

The question that we are asking, after all, is whether or not the carrier would be better off with the traffic at the rate that exists or he would be better off to shed the traffic, if no higher rate than that is capable of being charged.

It is really the other side of the same coin. It is a question more, perhaps, of alternative cost than of anything else. What seems to me really relevant is to consider the relative cost levels at the differing volumes of traffic that would result from alternating the rate structure.

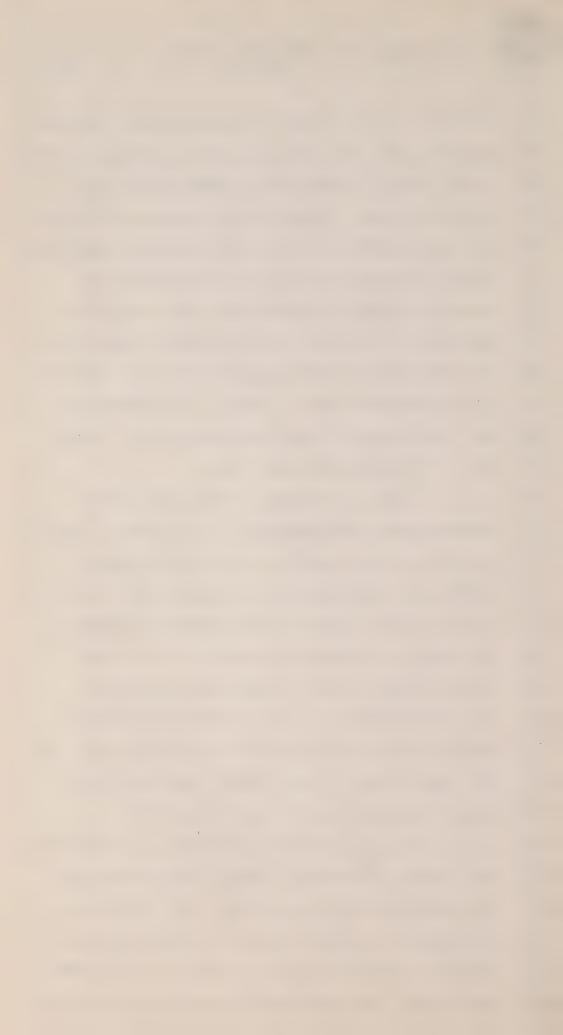
- Q. Dr. Williams, would you consider it proper for the railways to be permitted to put in rates lower than necessary to meet the competition if, by doing so, they could maximize their net revenue?
  - I really see no objection to that, Mr.



Brazier. That is certainly true in the case of carrier competition if, for example, we have a situation in which — and possibly I might cite an example that would clarify the thing. Several of our railroads some years back made a study of the cost, simply using the Interstate Commerce Commission formula, cost of handling each commodity category of traffic which they had in their possession. The results which they found ranged from one commodity, which was moving at some eight times the fully distributed costs — that is, the revenues were some eight times the fully distributed costs. Others were at a substantially lower level.

Now, in a situation of that kind on that particular high rated commodity in the course of a whole calendar year they had only twenty-four carloads of traffic, and upon examination it appeared that the only reason they had the twenty-four carloads of traffic is that there was a particular service at one of their terminals which was not available from any of the trucking companies. It would in that territory very likely have cost about one-half as much as the level of that rate to truck. Such traffic, and quite clearly the great majority of it all was being trucked.

Now, in a situation like that, it also appeared that the fully distributed costs by railroad were only about one-third the cost by truck. And it would be a proper result, I think, both for the railroad and for the public interest in such a situation if the carrier were to make a rate that would secure for it under those



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yourself want to put into that. We I I have in mind, Dr. Williams, is a case where the " king of such rates

Now, is there any qualification that you

circumstances all of the traffic; that is to say. if the rate below the level of truck cost and sufficiently below to offset any differential in service and to do so quite affirmatively.

On the other hand, I think the carrier ought not, either in its own interest or in the interest of the shipping public generally, take that rate lower than is necessary to accomplish such a result. I think the test would be the one you suggest, that level of rate which would have the effect of maximizing its net revenue above its variable costs associated with the traffic, and I would see no objection, although as you are probably aware for some thirty years we have acquired -- since less than thirty, twenty-five years now, since the passage of the Motor Carrier Act - and until we got into great controversy in the last two years, the principle that among our regulated carriers none of them ought to be allowed to do any more than to meet their competition. But, from an economic point of view, the meeting of competition does not seem to me to give any answer to where the rate relationship ought to be.

COMMISSIONER MANN: Dr. Williams, if I may interrupt for a moment. You rade, perhaps I might say, a categorical statement to carriers ought to be allowed to make rates lower than ecessary to meet the competition.



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may be designed or may have the result of eliminating the competition. Are there ary safeguards that you want to suggest?

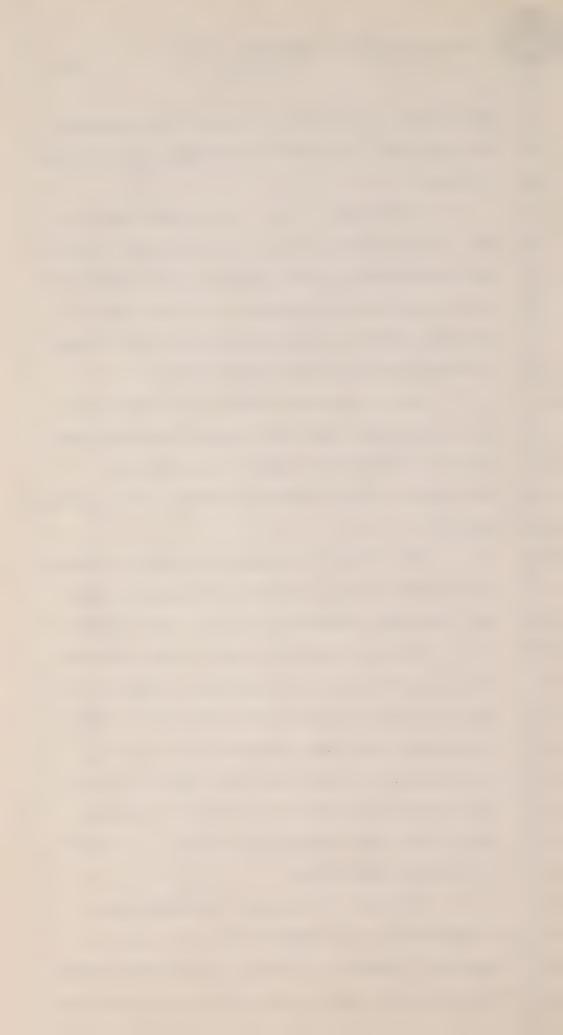
THE WITNESS: Well, I was already accepting what I thought was Mr. Brazier's qualification, that the rate which was below that necessary to meet competition was one which would maximize the net income from that particular traffic to which the rate applied, and that is certainly an appropriate qualification.

As you are surely aware, we have had an awful lot of controversy about this question that comes under the head of "destructive competition", which our Declaration of Policy Interstate Commerce Act specifically mentions.

The Commission is under obligation to exercise its regulatory powers to the end, among other things, that destructive competition small not dome to prevail.

From the economist's point of view, however, a rate, no matter what its relationship to that of some competing form of transportation, which has the effect of maximizing that revenue and which is in fact a remunerative rate and one that falls below the level of out-of-pocket costs and has the effect of minimizing losses, rather than maximizing net revenue, is no kind of destructive competition.

In short, the economist would not accept. as a general rule the definition which has come to be applied as a matter of law under our interstate Commerce Act, or sometimes under certain other of our legislation.





It is, after all, one of the functions which the economist places considerable store by, of competition to prevent the development of less efficient or inefficient enterprises, and should they come into being, to ensure their disappearance. It is a part of the regulatory process of our pricing system.

So that I would not, I think, be inclined to put any more qualification than the one which I thought Mr. Brazier suggested in the first instance.

page 17 of the volume for which you have so much responsibility, namely the Peageral Transportation Policy and Program, where you say the government should retain sufficient control to prevent destructive competition aimed at driving out competitors on a basis other than economic efficiency.



scribe to that now as I did then, but I would not —
taking that question of relative economic efficiency,
in the case we were just talking about there could be
no doubt that the economic efficiency of the carrier
makes the lower rate surpass that of the other. It
could be that in the first instance we had no indication of that. We might simply be moving from a very
high level of rates to a lower level of rates and it
would be open to the carrier whose rate had been undercut to meet it before this reduction if his own economic
situation permitted it in the same principles.

THE CHAIRMAN: All you have said is tied to greater freedom on the part of the carrier in the making of rates?

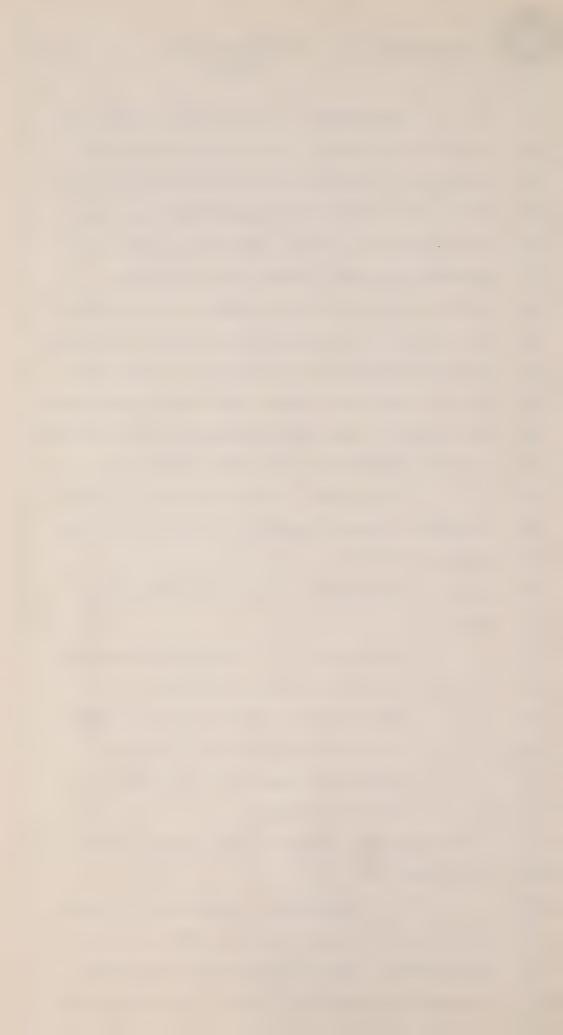
THE WITNESS: It is tied to that, yes, indeed.

MR. BRAZIER: Q. Further on on page 37, starting with the last sentence you say:

"Many commodity classes within the United States include significant volumes of traffic which appear to be moving at below cost levels."

Is that statement related to your Appendix B or had you in mind ---

A. Not entirely. That is part of it, Mr. Brazier, but we made a study at the time of the so-called Weekes committee, the president's cabinet committee on transportation policy, that went a little



selves in particular hauls.

which the Commission itself reports. What interested us, although it did not particularly astonish us, was if you take any of these commodity groups, possibly even most of them, you will find inside the groups even greater efficiencies with respect to the probable cost of the hauls. That is, you find many of them so I intended my statement to imply a little more than merely that we had had many broad commodity groups because individual differences were in that kind of relationship. We also found it within these more narrow commodity groups them-

more deeply into matters than simply commodity class,

Q. When you were making that study you were measuring the revenues against average costs of hauling in the particular area?

A. We were, necessarily. We were not, of course, attempting to pinpoint a particular relationship which possibly ought to be called into question. We were simply trying to look at a general situation so we used an average variable cost, not the out-of-pocket cost, and the Commission devised their own level for purposes of testing that and then compared the revenues in actual movements derived from the waybill sample within many of these commodity groups. You do, when you employ that method, get some unacceptable and incredible results. For instance, it would appear from such comparison, at least it did appear at that time, that the traffic in iron ore of the United States roads was unprofitable traffic. We know certainly



from the performance of the roads which are largely war roads that this was hardly the case, upon further examination. However, if you take ore movements and do no more than apply the Form A costs and make certain adjustments for certain peculiarities in that movement you come up with a cost more appropriate to the movement of ore that is substantially below the average. We did not have much of an opportunity to do anything in the refining of that and we used the average territorial costs.

- Q. Would it be true that in the United States you have a great number of different railways operating in the various regions?
  - A. We certainly do.
- Q. And there would be quite a difference between the different efficiencies of the different railways?
- efficiency among railroads is always a thing which is very hard to judge because no two railways operate under the same circumstances. Any direct comparisons, while they may appear to suggest differences in efficiency, are also subject to many, many qualifications and other possible influences, so that a person would be a very brash one indeed who suggested that on a statistical resolution X railroad was more efficient than Y railroad. I think it is generally accepted that we do have some differences in the efficiency with which certain of our carriers are operated and managed. We have some further differences of importance in their ultimate net



result arising from differences in financial structure and financial history and so on.

- Q. And there would be a difference in actual costs?
- A. Oh, yes, there is no question about that.

  You have the composition of the traffic, the relative

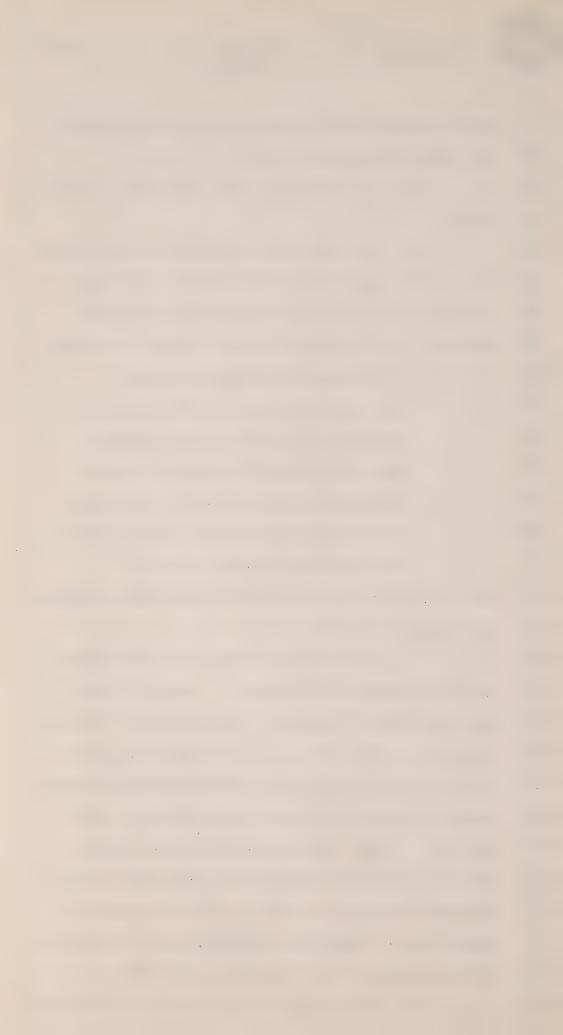
  circuity of the roads and other factors, but there

  certainly are differences from one railroad to another.
  - Q. Turning now to page 39 it says:

    "That carriers will, even where forceful competition does not now exist, examine their rate structure carefully to remove any incentive to the growth of competitive service which is not capable of being made more economical than rail service."

Had you in mind in that section what we spoke of yesterday as captive traffic?

- A. It may well be that some of the traffic could be referred to as captive. Some of it may also have another alternative which is about over the threshold. That is to say, there may be a good deal of traffic which is capable of being handled by another method but which, up to this point, has not in fact shifted. What I was referring to is any traffic which carriers now possessed as to which there was any reasonably immediate prospect of the development of other forms of transportation/might produce a diversion of that traffic at some reasonably early date.
  - Q. Your thought being that it is better for

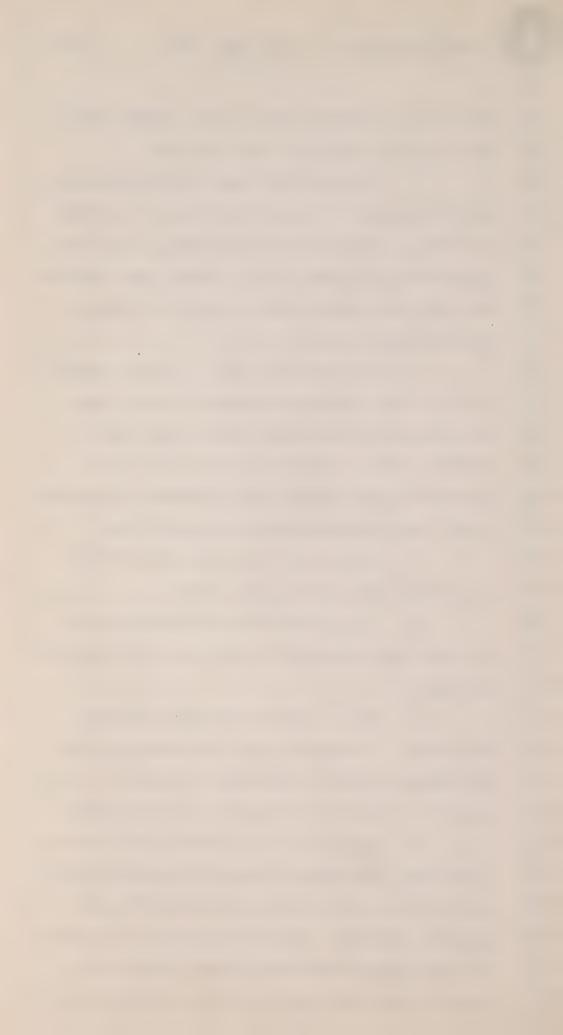


try and get it back after it has been lost?

A. I think it is better for the railroads

the railways to preserve their traffic rather than to

- and the community of shippers and the public interest,
  all three. It means, instead of making a shift that
  is uneconomic and then trying to correct that situation,
  you avoid that economic shift in the first instance or
  at least hopefully you do.
- Q. Just one last point. In your Appendix
  B you give the United States eastern district boxcar
  costs with 38 per cent empty return, 10-ton load,
  January 1, 1950. I presume you have given those
  particular figures because they represent a volume that
  is very much subject to motor truck competition?
- A. Yes, I used the 10-ton load because a 20 to 24-ton load is not a usual weight.
- Q. And you used the eastern district because the truck competition is stronger in the eastern
  district?
- A. No. I had no particular reason for doing that. This might equally have been done with the southern district or the western district. I had no special reason for choosing the eastern district.
- Q. Would you just in general terms, having in mind what the nature of the western district in the United States -- in a general way compare with the Canadian situation? Would you agree that the proposition that perhaps the western district is more comparable in operating conditions than the eastern one



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would be to the whole Canadian system?

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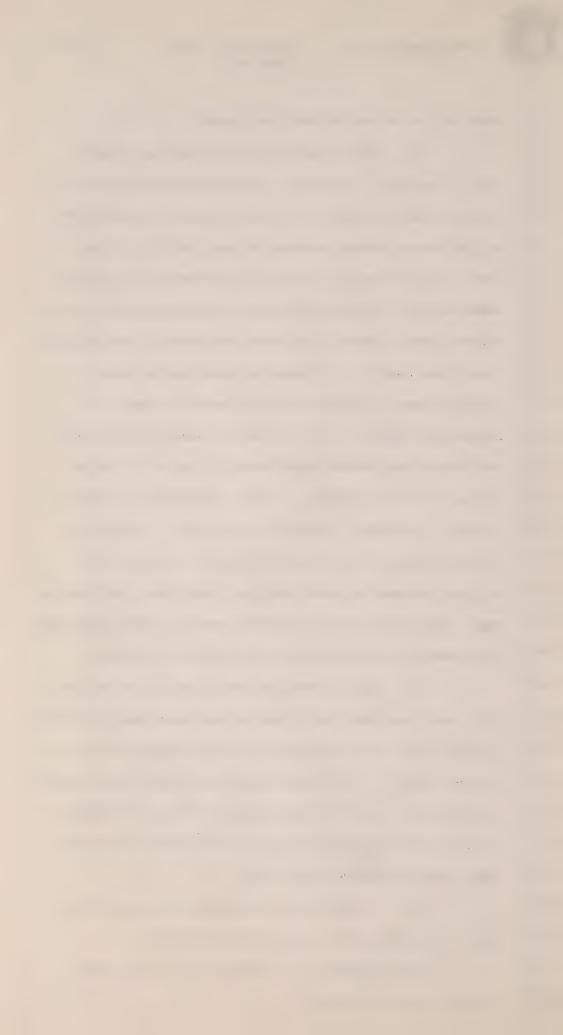
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A. Well, I would suppose that is broadly true. We have, of course, in our western district. in the very eastern part of it, the densest railway system in the United States, between Chicago and St. Louis. That is on the extreme margin of our western territory where we have industrialization in some portions of our country west, generally in what was known as the western trunk line zone 1. I suppose there may be some corespondence between that and eastern areas of industrialization. As far as the west is concerned, our operations are at least broadly similar to those you get in the prairies. Then we have the mountain problem, of course, further to the west. I think as a broad statement it would be true that within our railroad system the area that you could most confidently make some comparison of with the Canadian condition would be our western classification territory in general.

- Q. Now, I have not the figures for January 1, 1950, and I am sure the situation may have been different at that time, but I do have the cost figures of ICC for the year 1958. It would appear from those cost figures, Dr. Williams, that the operating and fully distributed costs in the western district in the United States are lower than the eastern district?
- A. I think that was probably true in 1950 also. Generally the course of operations ---

up just a little louder?

THE CHAIRMAN: I wonder if you could speak



THE WITNESS: Yes, I will try. I think

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the general course of operations in the United States
has been that whereas prior to the Second War it
appeared generally speaking that official territory
costs were somewhat lower in the south and west, as we
moved into the postwar inflationary period the inflation
of costs in the east was unfortunately considerably
heavier than in the south and west and we moved into
the opposite condition. This is partly as a result of

MR. BRAZIER: Q. Reading from the 1958 study I notice that 1000 miles for 10 tons fully distributed costs in the east are \$1.83.3, while in the west for the same amount, the same length of haul, it is \$1.66.3?

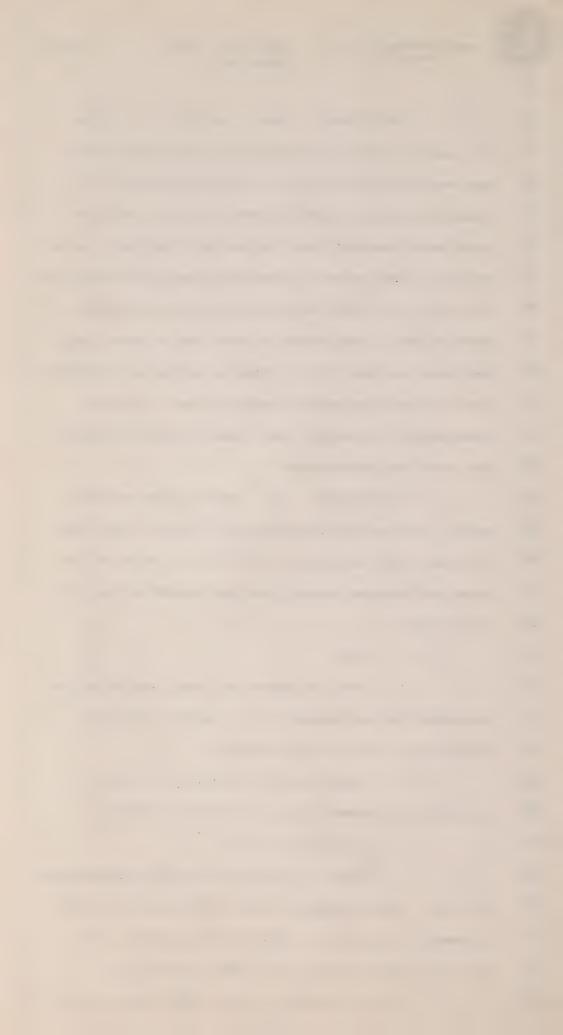
the fact that the eastern territory has a shorter

average haul and higher cost elements than is true of

A. Yes.

the other two territories.

- Q. Now, in respect of that, the situation indicated in your Appendix B, I suggest, would be modified as the loads got heavier?
- A. What you are referring to is the relationship between the costs and the revenues.
  - Q. And the revenues?
- A. Yes, of course, this would unquestionably be true. The increase in the carload makes a modest increase in the cost of handling the carload, and, therefore, often produces a lower cost per ton.
  - Q. Mr. Stetchisin has just called to my



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attention that the figure I gave for the west was for gondolas and the true comparison shown for boxcars, \$1.83.3 in the eastern districts and in the western districts, \$1.44.5, which is a fairly large difference?

- A. Quite a considerable difference.
- Q. And these cost studies all indicate that as you increase your loads the unit costs drop?
- A. They do indeed, and fairly sharply, as a matter of fact.
- Q. Looking at these cost figures, taking 25 tons where we have a 10-ton fully distributed cost of \$1.44.5, for the same haul for 25 tons it is just 79.7 cents. That is the sort of difference?

A. Yes.

MR. BRAZIER: Thank you very much.

THE CHAIRMAN: Mr. McDonald?

MR. McDONALD: I have no questions.

THE CHAIRMAN: Mr. Sinclair?

## CROSS-EXAMINATION BY MR. SINCLAIR:

- Q. Dr. Williams, as I read your paper, as you appear before this Commission you deal with three general matters, passenger, branch lines and freight rate structure and regulation?
- A. Yes, I think that is a reasonably correct summary.
- Q. Let me deal with them in that order, if I may. Dealing first with passenger on the Canadian



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Pacific, whom, by the way, I represent. On the Canadian Pacific what proportion of miles of road would you think has no passenger train service?

- I would not have any idea.
- Well, as a man who studied transportation and the effects of it what would your guess be, your educated guess?
- A. Well, I do not know. I suppose your situation might well be different than our own in respect of how far you maintain passenger service on line mileage. We have a good many railroads on which we have no passenger service any more and they have fallen into the category of freight only. We have had a wide range, also, of abandonment of branch line services. I cannot say whether the conditions in Canada are at all similar to that. That is a matter of fact which could certainly be ascertained by looking at your figures for mileage on which passenger is maintained and total the miles operated, which I have not done.
- Well, for instance, the roads in the States that have not any passenger service are outfits like the Rutley. You have no major road comparable to Canadian Pacific or Canadian National in the States?
- Not at all, nor have we any road quite so large in dollar receipts comparable to the Canadian Pacific.
- Well, the effect of the transition of passenger service is a matter that has to receive some



weight and has to be looked at in a realistic and orderly way. You would agree with that?

A. I certainly would.

Q. So that you are under no misapprehension, the statistics and the analysis will show that for Canadian Pacific it has passenger train service on slightly less than 50 per cent of its miles of road.

I wanted, then, from there to say to you
this: if a witness appeared before this Commission,
a Canadian who was thoroughly familiar with the
Canadian Pacific service and the area served by Canadian
Pacific passenger train service and thoroughly knowledgeable as to the interplay of alternative transportion, if such a witness said to this Commission
that he knew of no passenger train service on the
Canadian Pacific which was required in the national
interest, you would not disagree with him, would you?

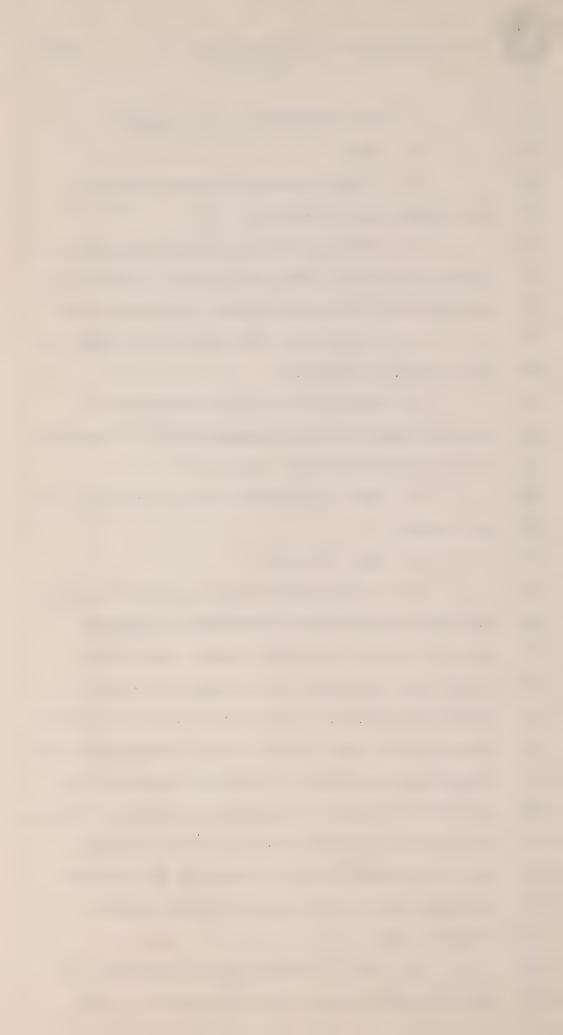




somewhere else.

## ANGUS STONEHOUSE & CO. LTD. Williams, cr.ex. TORONTO. ONTARIO (Sinclair)

- A. You said that none was required?
- Q. Yes.
- A. I would certainly disagree with him in the present state of affairs.
- Q. Then, you tell us from your knowledge -- by the way, how many times have you been in Canada and travelled over the transcontinental Canadian Pacific?
- A. I have never been across your country on the railroad or otherwise.
- Q. Then, you tell this Commission what passenger train service on Canadian Pacific is required in the national interest -- which one?
- A. That is a question that is impossible for me to answer.
  - Q. Well then, why ---
- A. I think you can say in general that, given the state of the Canadian Transportation system at present, it seems to me quite obvious that without present rail transportation some manner of service is going to be required; is required not only now but will be required for some period of time. The question I was raising was a question of a long run economy and with particular reference to the Canadian situation. Secondly, the question of whether, given a condition in which railroad passenger service is required, the burden is one which ought to fall upon the freight traffic or
- Q. Well, I wanted to stay on specifics: we have a specific problem, and dealing with it in the



abstract is not too helpful, maybe. You said that you would disagree with a Canadian, who knows the Canadian Pacific and the areas it served. You would disagree with him when he says there is no passenger train service on the Canadian Pacific at the present time that is required in the national interest?

- A. Yes, I would be inclined to disagree with that.
  - Q. You do disagree?
  - A. Yes.
- Q. Now, my question to you is specific: which passenger train service have you in mind on the Canadian Pacific? I am not interested in any other railway.
- A. Well, I think that is a question which cannot be answered by a witness who is not intimately familiar with your passenger train schedules and local conditions, but I disagree with the statement you make as purporting to be a statement by one experienced with the service and the territory when he says that no such service is required.
  - Q. In the national interest?
- A. Because I find it very hard to suppose

  -- and I am speaking in generalities because I can do

  nothing else, not knowing your passenger service in

  detail -- I find it hard to suppose that it is also

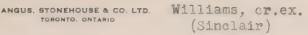
  true that reasonably adequate substitute service is

  in all cases presently extant and operating which would

  take over the passenger load which the Canadian Pacific

  now handles.





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Q. ... by generality?

A. Oh, this is ---

- Q. Did you know that the Trans-Canada highway paralled the Ganadian Pacific with the exception of a very small portion?
- A. I have understood that small portion had been declining for quite a number of years and that the Trans-Canada highway was very nearly complete.
- Q. And did you know that there were scheduled bus operations between every major Canadian Pacific point?
- A. No. I would have assumed that to be the case, but I have not made any check on where the bus services go.
- Q. You and I can agree that the national interest, could we, means that it is a benefit to Canada as a whole -- that is "national interest"?
- A. Yes, this is true. I think our definitions would be similar.
- Q. There may be people who think a passenger train service is in the local interest where they would not be able to make a case out for it being in the national interest: would you agree with that?
- A. I not only would agree with it but, unfortunately, we have had in the United States countless examples of precisely that.
- Q. In giving your answer, if you did not make an analysis from specific knowledge of alternative service and traffic movements, you could quite easily be misled ...



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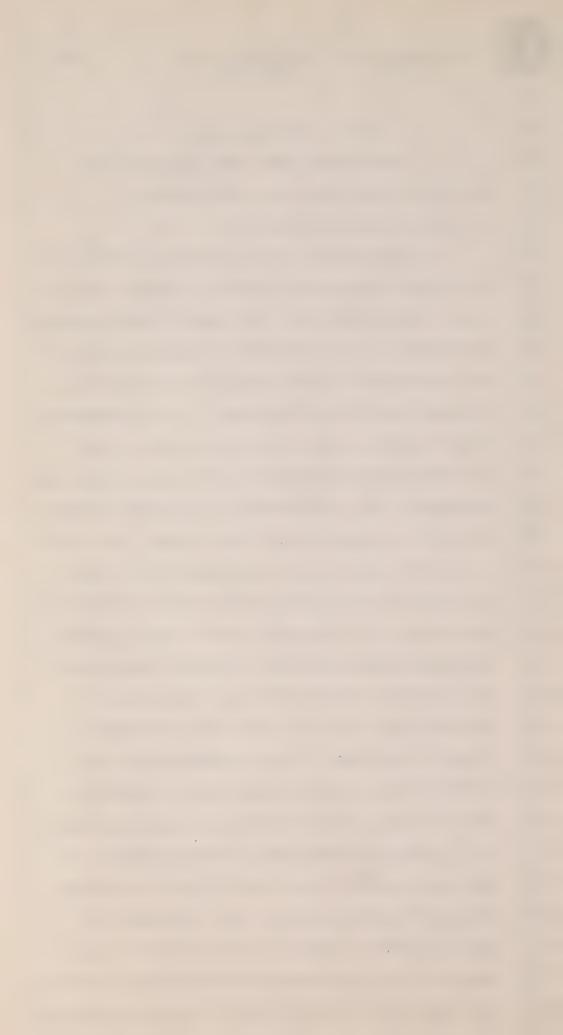
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A. This is certainly true.

COMMISSIONER MANN: What aspects of the national interest enter into the retention of passenger service, Dr. Williams?

THE WITNESS: Well, it may well be that they do not have your present elements of financial interest, as Mr. Sinclair and I have just agreed it may be defined. In our study in the Department of Commerce relating to the problem in the United States passenger service we certainly have the same conditions. It is questionable whether anywhere in the United States there is not reasonably adequate substitute service or, if there does not happen to be, it is certainly questionable whether it cannot be provided by some other means. Yet -- and I gather from what little I have heard of the case -you are also in the position where whatever the national interest may be a considerable part of your population and perhaps some considerable political element does not yet see it in quite that way. This may be a situation such as we dealt with in the Department of Commerce report where it is not expedient nor, as a matter of fact, in our case politically feasible to make a one-shot transition from the present situation into a reliance on other forms of transportation. We might say very well if you want to look at this thing coolly and calmly and coldly, quite obviously the national interest suggests we have not got any places any more, beyond some commutation operations, including some important ones that we have, or possibly some short



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distance operations, where the mass movement is required as between New York and Philadelphia and Wilmington, let us say, where it would not be a more economic thing for the transportation system overall if we took the railroad out of the passenger business and substituted other methods. Unhappily, however, this is not a thing we are prepared to face as a matter of practicality. So, the railroads in our country, and I suspect in Canada also -- and I have seen some evidence to that effect -- are faced with some heavy public resistance. What I was trying to suggest was, that in the face of that kind of problem we cannot. after all, wipe the service out. We have to try to move in the direction we think lies in the national interest, and we may have a period of time during which that movement will have to be obsorbed in order to gradually overcome the opposition that exists to it. If we could have it strictly on a cold analysis of the national interest, that would be something else again.

MR. SINCLAIR: Q. Dr. Williams, from your study of transportation you would agree that passenger train service was highly profitable in the 20's and in the 40's: correct?

A. Well, it was in the United States, and I know no reason why it may not have been here also. As a matter of fact, in 1921, in our general rate level proceeding, our Commission found the passenger service to be more profitable than the freight.

Q. You would agree that when passenger train



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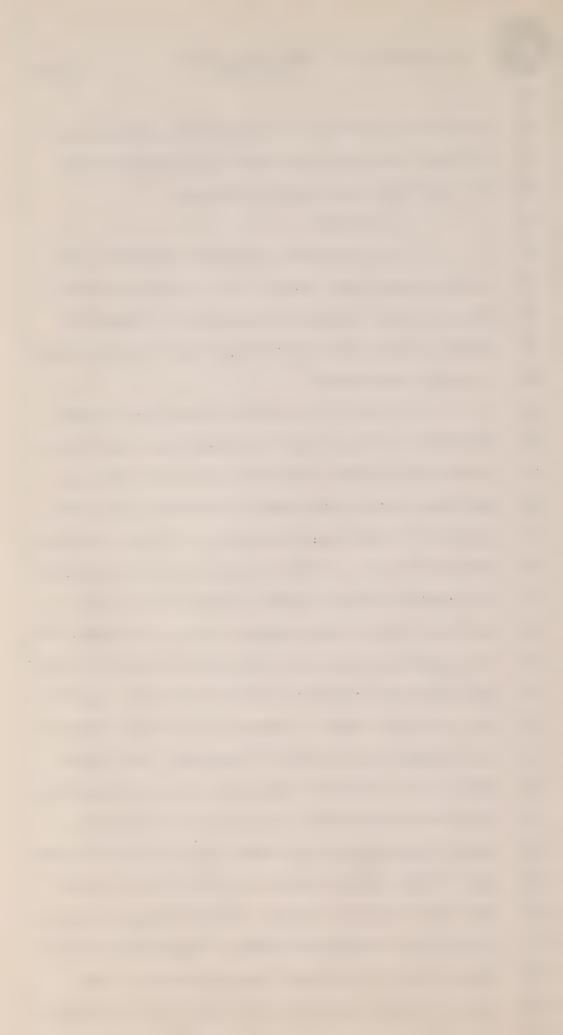
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service was profitable it assisted and contributed to the total transportation burden and thereby relieved that cost that was carried by freight?

A. It did.

Q. I suggest to you that in fairness, now that passenger train service is in a deficit position, that until for a reasonable period the railways can phase out of it there is nothing wrong requiring freight to carry that burden?

A. Well, I would not be inclined to agree with that. I might accept the proposition that it was a matter of no great consequence if it were true the passenger deficit were a small proportion of the total picture -- a very small proportion -- so that it had no great effect. In our case the deficit for the railroads as a whole has been so great it seems to me to have manifest adverse effects against which, in fairness, now as compared with what might have been in the early 20's, does not weigh very heavily with me, because I think it has the result our whole freight rate structure has got to be higher than it would be otherwise. This means when we look at the railroad in the face of alternative forms of transportation, our shippers do not make a correct appraisal of its capabilities, and cannot in the face of that kind of situation, and its results in the fact that we use the railroad less for things for which it has a real economic advantage in the freight service than we would if passenger service were not a thing covered by the freight rate structure taken as a whole.



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Q. In view of that answer, may I say this to you: was it brought to your attention that there appeared before this Commission one of the most experienced industrial answers in the country?

Mr. George Paul is the name -- did they bring to your attention the transcript of Mr. Paul's testimony?

A. No, I have not seen it.

Q. Well, Mr. Paul said at page 9937 of volume 54 that he would not object to freight contributing on a temporary pesis until this passenger gap is adjusted -- I am paraphrasing him. Now, if a practical traffic --

MR. FRAWLEY: That is Swift & Company.

MR. SINGLAIR: Q. If a practical traffic manager in Canada would take that view, why would an economist from a foreign country disagree with it?

A. Well, I do not think it makes any difference where the economist comes from.

Q. You don't?

A. I think most economists would argue in principle that one ought not in the interests of securing some reasonable a rotation of transportation function between the different forms in the performance of the freight service, allow the level of freight rates in the structure and irright rates of any form of transportation to be cluttered by your deficits inherited from some other service. This results if the amounts are at all significant, and a misallocation of traffic between forms of transportation, and I think an



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economist is bound to say that is not a good result. Your traffic manager may feel he is quite willing to put up with this situation and perhaps a great many others feel likewise, but the economist would worry if that traffic manager has some alternatives put to him, notwithstanding what he may have said here, he may, if some other form of transportation which has no deficit to carry, go out and put some of his traffic on that form of transportation on a comparison between its rates and your own rates, or comparing his cost of private transportation with your own rates and reaching a decision which is not necessarily a good economic decision under the circumstances. It is good for him, but it may not make sense for the relationship of the

Well. let us test it this way: you were Q. in a position of regulatory control in the United States during the war; correct?

> We were. A.

two forms of transportation overall.

- Q. You were.
- I was? A.
- Yes. Q.
- Oh, you are referring to my personal situation?
  - Yes. Q.
  - A. Yes.
- Dr. Williams, at that time when passenger traffic was contributing to freight did you recommend that they should be separated and freight



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States and in Canada it did do so?

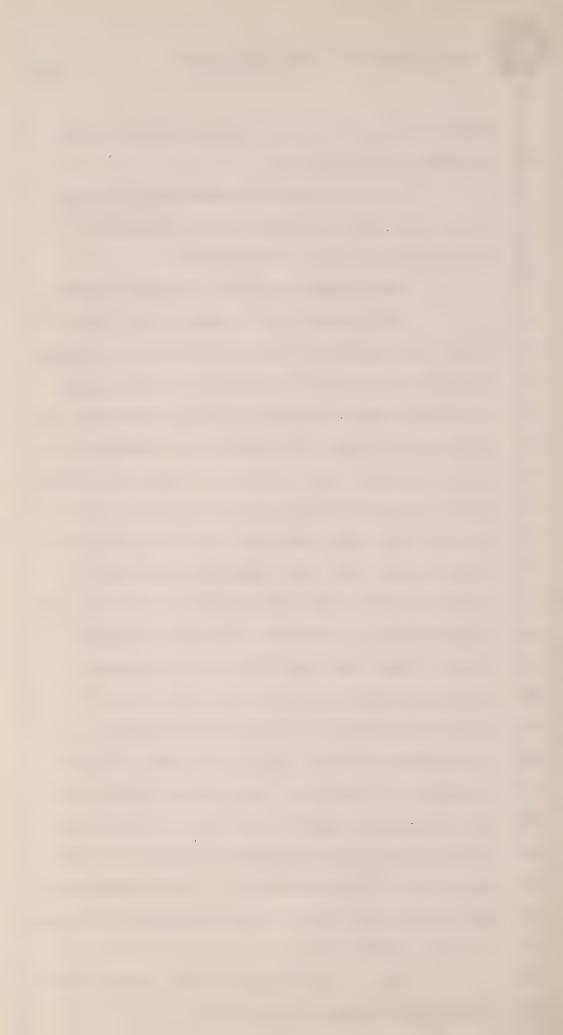
should stand on its own feet and not have any burden relieved by the passenger?

A. No, I did not recommend any such thing.

I was busy doing other things than worrying about transportation economics at the time.

THE CHAIRMAN: Was that a temporary affair? THE WITNESS: Quite temporary, but it is an interesting phenomena that the United States railroads! increase in passenger revenues proportionately were far greater than the increase in freight revenues, and, as a matter of fact, for several years during the war period passenger traffic appeared to make a net revenue contribution greater than our freight service, if I recollect the facts correctly. We did not have before us any issue at the time; nobody was proposing to reduce pasenger fares, and I suppose even if they had government policy would have intervened on another ground, namely, that with our railroad passenger service as overloaded as it was it was not wise to extend any additional stimulants to its further intensification of use. But if this were a situation occurring at other times, over a longer period, and had occasionned comment by me, I would take the same position with respect to passenger service as I would with respect of freight service. I see no more reason why the passenger service ought to subsidize the freight than the opposite case.

But in point of fact, in the United



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Q. The sharing with railway management, railway owners, the losses from passengers -- that is

- A. Yes, during the war for a couple of years, and it did in our case in the transition period immediately after the first war.
  - Q. And throughout the 20's?
- No, not throughout the 20's; I do not believe so. The passenger situation went through a gradual decline; it was a gradual decline, but it began to feel the impact of a number of competitive factors during the 20's.
- Q. It did not become unprofitable in the United States until the 30's?
  - A. That is right; not unprofitable.
- Q. And therefore it was contributing over and above its variable cost to carrying the burden?
- A. Yes, I agree; as compared to what it was doing in the early 20's, it was becoming a little less capable as the decade went on.
- Q. Let me put this proposition to you: if it was policy for a railroad, to phase out of passenger business except where it could meet its avoidable costs, and that in a transition period of ten years that freight should, as it has in the past, take whatever disabilities there were involved, as an economist you could not really disagree with that?
  - A. You say "disabilities"?
  - Yes. Q.
  - What do you mean by "disabilities"? A.



an orderly way of making a transition, is it not?

A. Well, let me see if I understand you.

You talk about phasing it out over a period of years

except in the cases where it covers its variable costs?

Q. Avoidable costs?

A. Yes, and you say that would be a reasonable approach to the problem?

Q. Yes.

A. Well, I think essentially that is what I have suggested elsewhere and would advocate.

Q. And during this phasing out period the disabilities of passenger would continue, as they have in recent years, to be shared by railway owners and freight?

A. Well, I think the proposition that one ought to undertake a phasing out, that it has to be a gradual thing and possibly something like ten years is a reasonable period. This does not leave me happy with the notion that if the figure is of any substance it is entirely wise to accomplish the phasing out by the sharing that you suggest. We have, I am sure, in the United States now for better than a decade done a great disservice to our railroads by following exactly this process. I am sure their competitive position today would be far better if they had not been carrying these passenger service deficits over that period of time, and I am distressed by the length of time / of this course and its resulting effect upon the

position of the railroads competitively in the freight



service. So that, I am not sure I would agree it is wise and, in fact, I have suggested that perhaps the time has come to pick that bill up elsewhere.

Q. Well, I will deal with picking up the bill in a minute.

--- A short recess --



MR. SINCLAIR: Q. Dr. Williams, one of

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the problems of unprofitable passenger train service is
the question of labour intensity; correct?

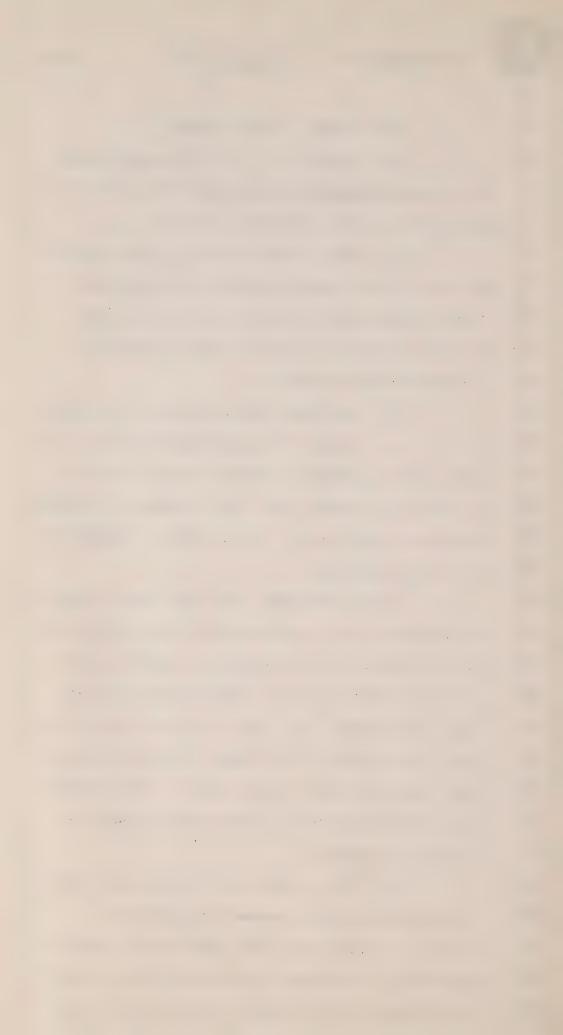
THE CHAIRMAN: Order, please.

- A. Well, I would not put it quite the same way, but I think I would come out to the same end.

  It has seemed to me, at least in our own railroads, that the problem is one that we would describe as a problem of load factors ---
  - Q. Would you speak up, please, Dr. Williams?
- A. We have in our passenger service a load factor that is probably something of the order of 25 per cent, as a general rule, and to operate a passenger service on a load factor, such as that, is impossible on a sustaining basis.

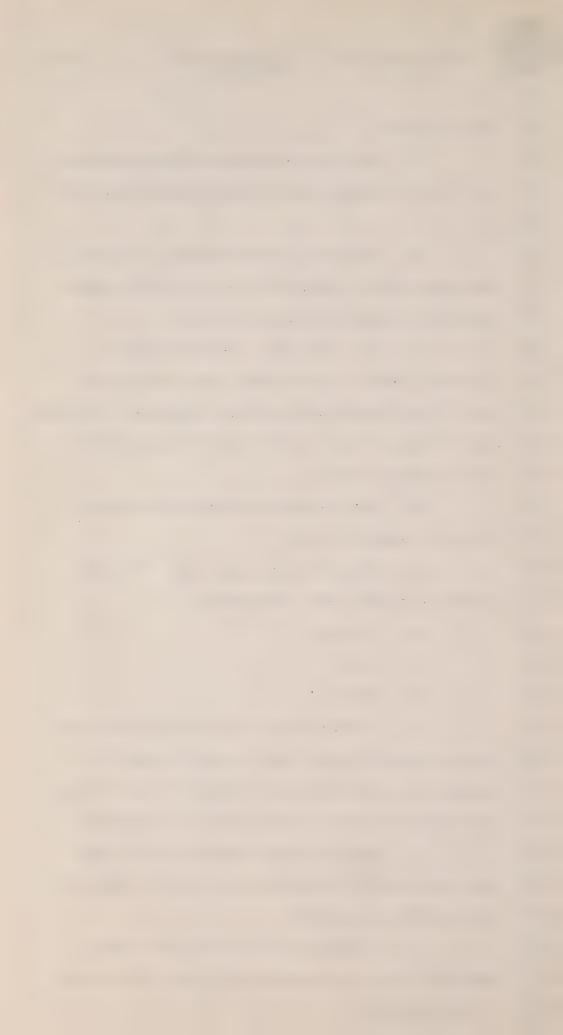
On the other hand, the factor that you mention is certainly a major contributor to that cost; that is to say, years ago we were capable of operating comparatively short trains and sometimes on relatively light load factors, in view of the fact that labour cost, which is one of the largest elements of the service, bore a different relationship to other elements of cost and to the level of fares than is the case at the present time.

Q. Did you know, Dr. Williams, that there is a marked difference between the approach of Canadian railroads and their rights under collective agreement as to how many employees they have to have on a passenger train compared to what exists in the



United States?

- A. Well, we have some variations ourselves, but I am not familiar with what the Canadian situation is.
- Q. Well, did you know there is a type of passenger train in Canada that can be operated with a train crew of three running in multiple?
- A. No, I did not. We have similar situations, however, and we have some situations in which we can operate self-propelled equipment in multiple units if they do not exceed a limited length, with crews as small as two.
- Q. This is only in electric interurban service, I suggest to you?
- A. Well, it has also come to apply in the use of Budd cars, for example.
  - Q. It has?
  - A. Yes.
    - Q. Where?
- A. I has been true on the Baltimore & Ohio railroad since they used that equipment between Washington and Baltimore, and likewise in their Pitts-burgh suburban service we had a similar arrangement ---
- Q. Would you mind telling me what agreement this is on? The Baltimore and Ohio? When was this agreement negotiated?
- A. I would not be able to pin it down precisely, but it corresponded with their introduction of that equipment.



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- Q. Now, Dr. Williams, in regard to this

- Q. Budd cars in multiple with a crew of how many?
  - Three. Α.
  - Q. What are the three crew members?
- A. As I recall, they have an engineer, a conductor, and a third employee who is known as a train porter. I do not know what organization he belongs to.
- Q. Then you say that they have that restricted crew on the B&O?
  - A. That is right.
- Q. Is that the only railroad in the United States?
- A. The Boston & Albany had it and had a court fight about it in a case of use of Budd cars between Boston and Springfield. I am not sure whether that situation still prevails.
- Q. And in regard to the general application of Budd cars in the United States, the labour agreements require the designation of a fireman and in lots of states two trainmen or a minimum crew of five?
  - A. That is quite true.
  - This has a material effect on profitability? Q.
  - It would have a very considerable effect, Α.
- yes.
- Do you know that the Canadian Pacific, since the introduction of Budd cars, has had the right to operate in multiple with restricted crew?
  - A. No, I did not know that.





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matter of passenger service, if a locality desires to maintain a losing passenger service you would agree that the deficit should be the responsibility of the locality which pressed for the maintenance of the passenger train service?

- A. Yes, I would think so, if you can put it down to a local condition.
- Q. Well, it would be entirely wrong to have an overall subsidy in such circumstances because the impact of the burden is not directed to the people who are requesting its maintenance?
- A. Yes, there is certain difficulty in that respect. Where you deal with long-range passenger service, however, it is perhaps a little difficult to identify what local interests are involved.
  - Q. Let me ---
- A. I have taken the position, though, that in, for example, such a matter as our commutation problem, which can be defined as a local problem, and the localities concerned can be ascertained, that this is basically a local problem.
- Q. Well, Dr. Williams, difficulties of definition never stopped an economist before, did they?
  - A. Oh, they very often do.
- Q. Well, they should not stop you where you can take a branch line and say, now, here is a situation where a deficit on this train operation is definable, and here is the service being offered. Now, this is a



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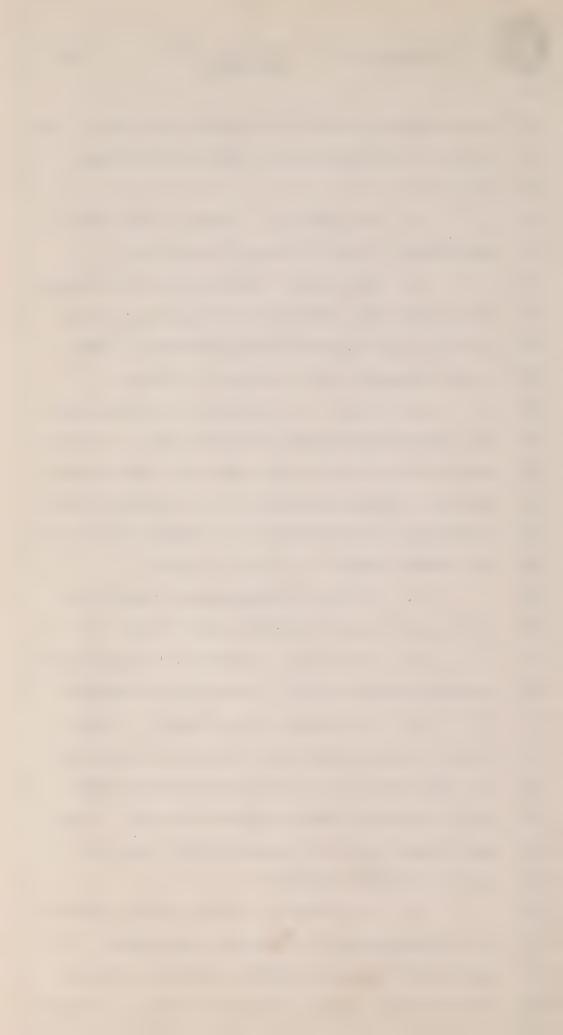
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local situation; there is no question about that. The service is maintained for the people on the branch line?

- Yes, this is. There, I think you can Α. define that as a local situation in that case.
- Q. All right. Let me give you the example of intercity runs, where the service, passenger train service, is set up and is serving intercity. Here we have definable local situations? Correct?
- A. Well, it is conceivable you might have, but I am not certain that you always would. Intercity segments are not infrequently parts of a larger system and more or less integral with it, so I think you would probably have, in many instances, a combination of local and somewhat broader use of such a service.
- Q. That only comes down to a question of defining how you run the trains; does it not?
- A. Not at all. I think it is a question of how the people use trains, not how they are operated.
- Q. Let me give you an example. There is a train operated between two intercities; it stops for one group; it stops for four or five hours and then picks up again and goes to another intercity. That may be looked upon as a through service, but it is really a commuter intercity.
- if it is arranged as a schedule in that fashion. It would seldom, perhaps, be useful unless the interval of time allowed people to transact business in the place

A. It is hardly a through service, obviously,



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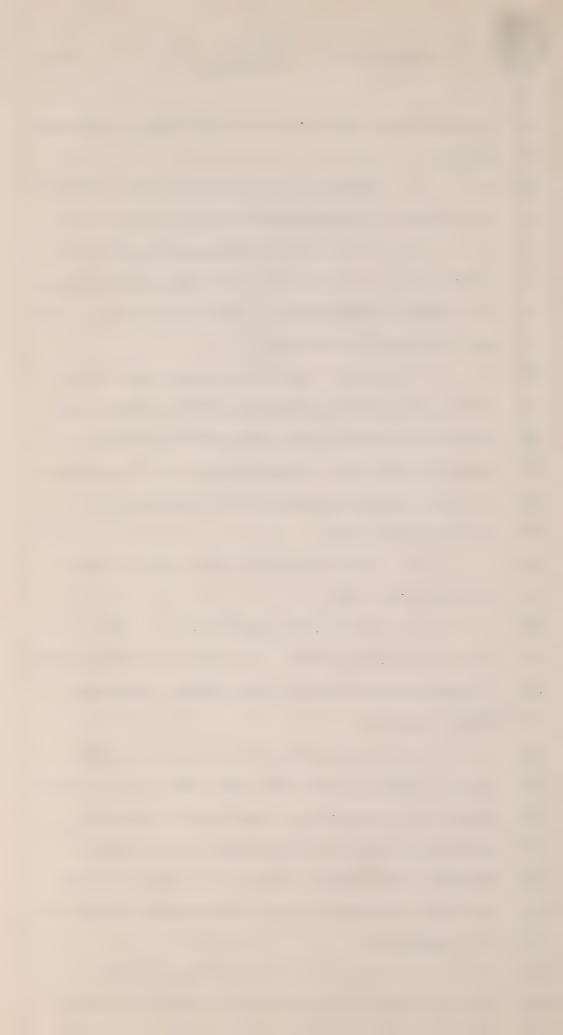
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in question and make use of it in that way as a through service.

- What you are saying is it is a question of analysis to determine whether it is local or ---
- If you want to undertake to ascertain whether it is to be described as a local responsibility or a broader responsibility, I think that is so. You have to look at it in detail.
- Q. Yes. Now, Dr. Williams, take a given railway that was built primarily for the movement of fright and freight is the major volume of traffic. Would you agree that the appropriate cost of passenger service on the railway should be developed on an avoidable cost basis?
- A. If we use the term the same, I would agree with you, yes.
- Well, let me see if we do. When I use the term "avoidable cost" I mean that it is inappropriate to ascribe to the service being costed a proportion of constant expenses?
  - A. Well, I did not use it quite in that sense, although it may come to the same thing. I would define it as a question of comparing the costs of operating the present service with the passenger business in the picture, and the cost that you could anticipate would prevail when the passenger service had been eliminated.
  - Q. Another way of putting it is that passenger train service should be costed on economic





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incremental costs? Correct?

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- A. Essentially so, except since our question is whether the service ought to be abandoned or not we are looking at the downward study rather than the upward.
  - Q. That is right, that is right.

Now, Dr. Williams, you have stated in your paper and you were cross-examined in connection with this by one of my friends, Mr. Cumming. You stated that major lines falling in the category of national policy lines had become integrated into the systems in such a way as, doubtless, to prohibit their abandonment. Speaking of Canada, you said that on page 34.

- A. Yes.
- Q. And specifically with the Canadian Pacific, which major national policy line did you have in mind?
- A. I am not sure that I had any in mind in the case of the Canadian Pacific. I think, however, that some lines of the National certainly fall into that description, but the term "national policy lines" is a thing which has been referred to in an earlier Royal Commission in which they have, as a matter of fact, an estimate of the mileage that fell in that category. But such understanding as I have of the history of the Canadian railroads does not leave me in possession of any idea that there are national policy lines within that meaning in the Canadian Pacific System.
  - Q. Dr. Williams, I have a note here I will





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read to you; I think it is the quickest way to put it, and then maybe you can please tell the Commission as to whether you would agree with this:

> "A notable necessity is greater freedom to abandon unprofitable light traffic mileage and, where necessary, to substitute highway service as a part of the railroad system. Where such lines cannot carry themselves financially, the interests of localities along the line and of railway employees must give way to the larger national interest on a sound basic rail transport network. The luxury of branches which sap the net revenues of vital railway systems can no longer be sustained. If local interests insist upon the retention of rail service in such circumstances, the burden of losses should rightly fall upon them."

Would you agree with that?

A. I would agree with it with a qualification. I think that in order to come to that kind of a conclusion it is first necessary to show that it is possible to perform the service in question by an alternative form on more favourable terms than it is possible to perform it by the existing rail grants.

THE CHAIRMAN: Who said that?

MR. SINCLAIR: Dr. Williams.

MR. FRAWLEY: The Chairman asked a question.



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MR. SINCLAIR: I answered it.

THE CHAIRMAN: When?

MR. SINCLAIR: When? 1959.

COMMISSIONER MANN: Is that by him, or is it from a collaborator?

MR. SINCLAIR: That question was put to him on a number of occasions and he, quite frankly, said his co-author said that.

THE WITNESS: We had a little discussion on that some years back.

I do not need to see it, Mr. Sinclair. That is quite all right.

MR. SINCLAIR: Q. At the time you wrote this you did not put any qualification on it at all?

A. No, sir, I think I did not, but I think it is a reasonable interpretation if such a thing depends upon an assumption that you can perform the transportation service more economically in some other way. Otherwise, the general proposition does not hold water very well.

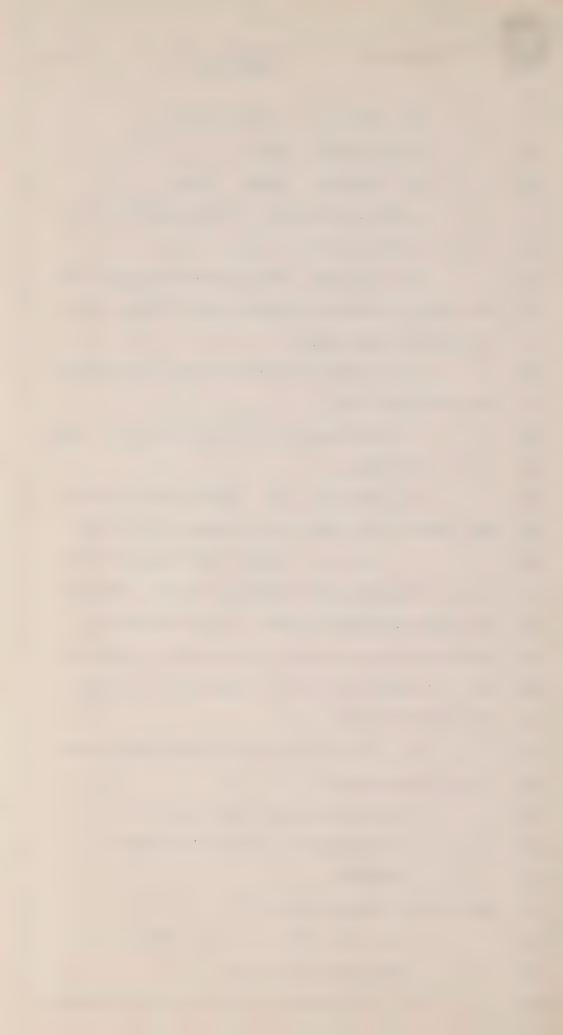
Q. But you would not put any qualification on the last sentence:

"If local interests insist upon the retention of rail service, in such circumstances . . ."

That is, the deficit operation ---

"... the burden of losses should rightly fall upon them."

A. No, I would subscribe to that statement.



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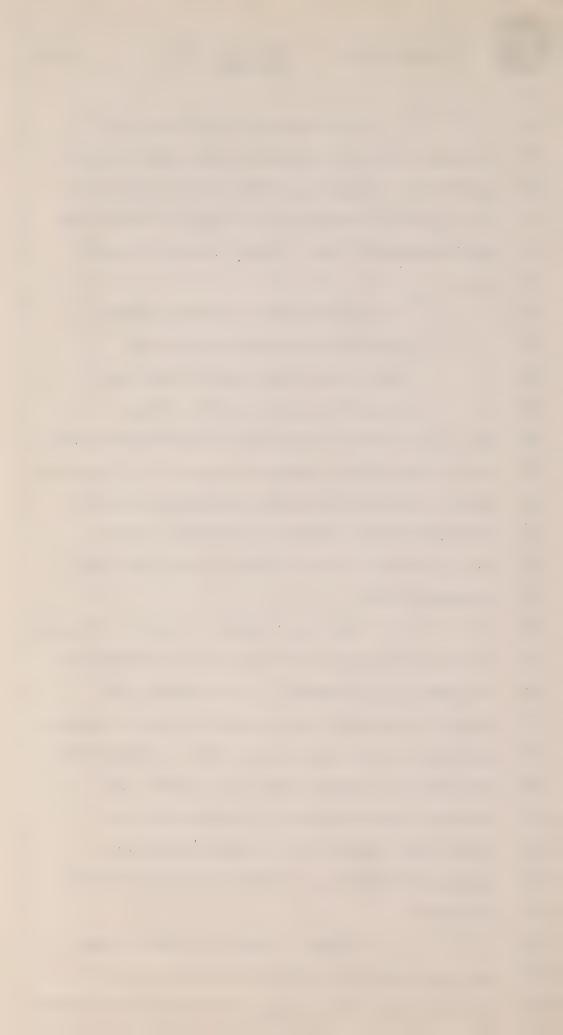
Q. Now, at page 35 of your paper, Dr. Williams, before this Commission, you point out that subsidies on uneconomic branch lines provide great difficulties in regard to the fixing of them and the administrating of them. Then, you go on to state that,

"A concerted effort to abandon mileage would be far more fruitful for the nation, and to the extent accomplished, at least as helpful to the railways."

Now, did you have in mind that one of the difficulties would be that once a subsidy was given, if it was, that rather than making the people requiring the service to be continued to pay for it, that the tendency would be that you would be unable to get rid of the uneconomic line?

A. I had that very much in mind. It seemed to me that the forces of resistance to abandonment of uneconomic lines certainly, in our country, are always far too great, and I would not like to see them enhanced by such a situation as that. A subsidy for this kind of a purpose, where the ultimate best economic result might well be abandonment, has exactly that trouble, that it might be one new obstacle to effecting an economic adjustment that is desirable.

Q. On page 5 -- and I am trying to deal with the branch line material all in one place, Dr. Williams -- you state on page 5 of your paper that there





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is from 60,000 to 70,000 miles of line now judged by students of the railway problem to be excess. I take it that by "students" you do not mean that students always agree?

A. No, not at all, Mr. Sinclair. I think there would be fairly general agreement that we had some excess mileage, but certainly there would not be agreement among all that the figure is of this order.

THE CHAIRMAN: They are like lawyers?

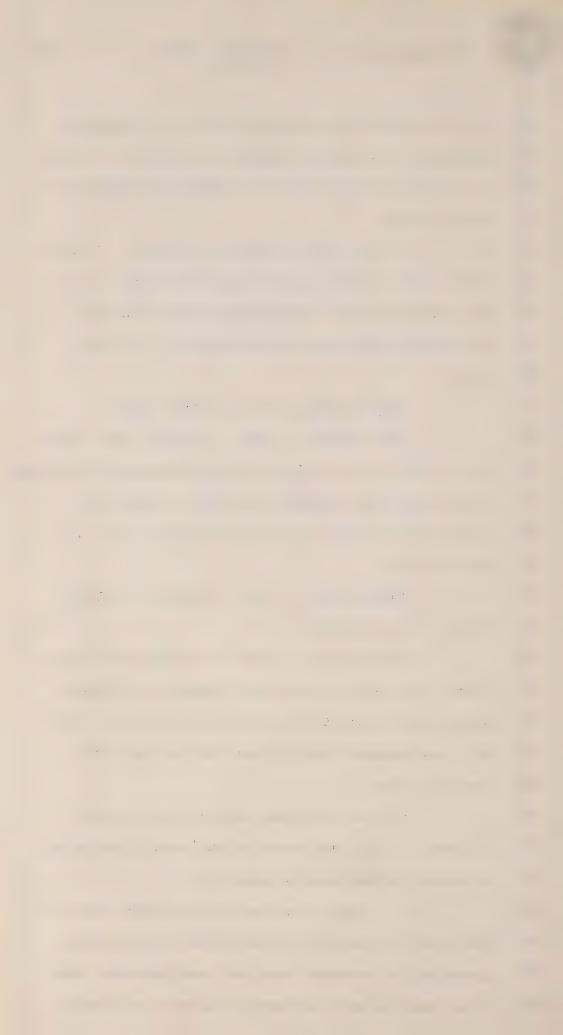
MR. SINCLAIR: Well, of course, sir, lawyers -- if I may draw this distinction, that lawyers, like other professional men, disagree sometimes because their clients do, and that professional men are always in that position.

THE CHAIRMAN: Well, you and Mr. Frawley disagree on principle.

MR. SINCLAIR: Well, Mr. Frawley and I disagree, as I said the other day, because I look upon myself as an economic realist, and I am sure he knows he is an economic royalist, and that is where the trouble arises.

Q. Dr. Williams, when you use the word "excess", do you mean excess in the sense of redundant or excess in the sense of capacity?

A. More in the sense of redundant than in the sense of capacity, but including, in our case, a great deal of secondary main and even important main lines where we have substantial duplication between



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competitive railway systems.

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- Q. Dr. Williams, you would agree with me that before a person can say there is duplication of rail transport, you have to know a great deal about the traffic moving; the topography; the established patterns ---
  - A. Quite so.
- Q. --- the linkage that the railway serves, and that you cannot usefully get that kind of an appraisal by merely looking at a map?
  - A. Oh, I would fully agree with that.
- Q. And I think, Dr. Williams, we can agree on this, that the true test of whether a branch line is redundant is the alternative common carrier cost of moving the traffic that may be moving over the branch lines?

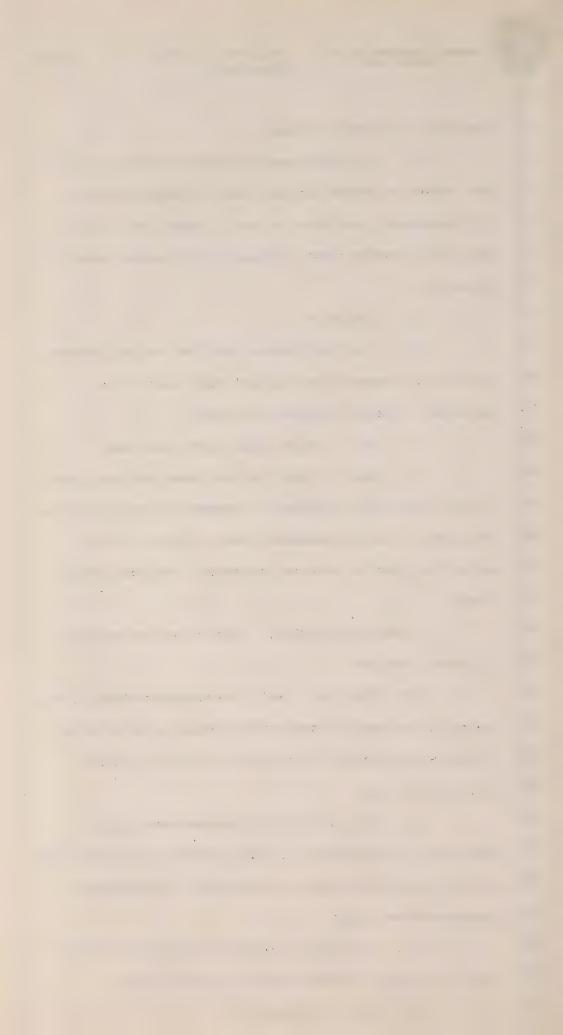
COMMISSIONER MANN: Why do you restrict it to common carrier?

MR. SINCLAIR: Well, Commissioner Mann, I was trying to see whether the witness would agree with me.

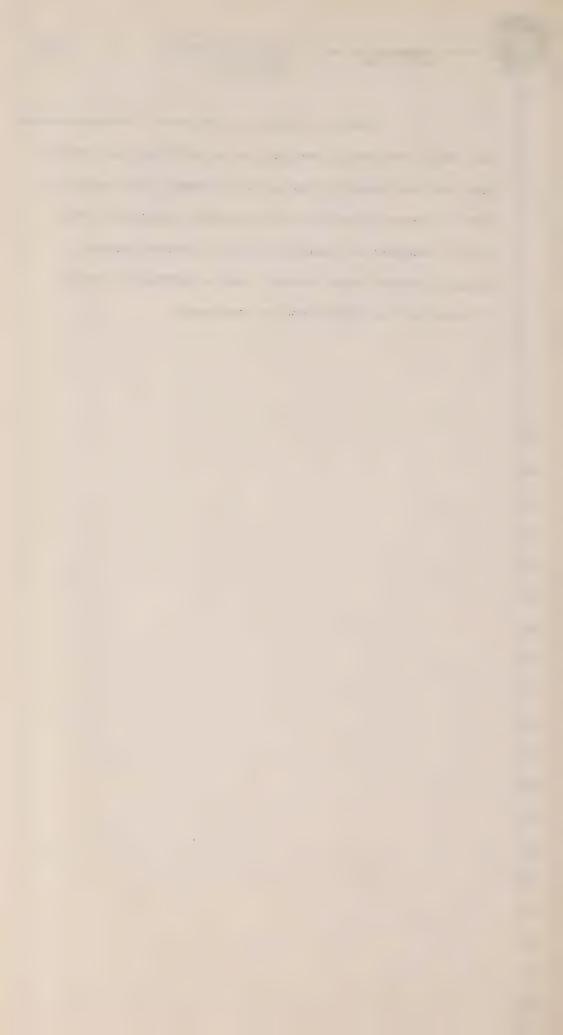
I have reasons which, if he does not agree with me,

I will put to him.

- Q. But, in view of Commissioner Mann's statement, let me take it in the general now and ask you whether you would agree that the test is alternative transportation costs?
- A. If one is looking at the question of the public interest, I would say yes, that is true.
  - Q. And, in looking ---



A. That is to say, if we have a transportation test that manifestly has got to be performed and which has been performed in the past by branch line railroad, then it seems to me that our question running to the idea of whether we ought to effect a substitution clearly depends upon whether that substitution can be effected at an equivalent or less cost.



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A. Oh, quite, yes.

- Q. An equivalent or?
- A. Or less cost.
- Q. If it is even then there is nothing to be gained economically, is that what you are saying?
  - A. There is not at the minute, certainly.
- Q. But if it was even and was capital already committed in one place it would be wise not to prohibit by abandonment that situation. Is that what you had in mind?
  - A. You say not to prohibit a substitution?
- Q. No, it would be wise not to prohibit the continuation.
- A. Oh yes, I think that is certainly true.

  Of course, in a given situation much might depend upon the state of the capital plant and your cost figures would reflect what would be needful over the term to make up any deficiencies in maintenance that were becoming urgently in need of continuation and so on.

  If the costs recognized were necessary to carry that capital investment I would certainly as a general rule, unless we found some advantage in the alternative form, that is a lower cost by the alternative form, recommend continuing the present.
- Q. And when you are looking at the alternative transportation cost we can agree that you must take in all costs. For instance, time costs of labour, investment costs, it would have to be done on a true analysis basis.



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Q. And if you were going to deal with private carriage one would have to be careful that it did have all true costs assigned to the transportation media that was being looked at.

> Right. A.

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- There is no such thing in economics as free time? It is just like a free meal?
  - If there is I have not heard about it.
- That question was for the benefit of Mr. Frawley because if there was free time in economics I am sure he could use it. Now, I think we can turn to considering the other aspect of your paper. Before I do that there are just a few points to perhaps clear up a few things before we get to discussing the matter of principle. Your appendix "B" which has been spoken to by Mr. Brazier in his cross-examination of you, I just want to carry or a little bit further from that. This is the basis of where you use this appendix to show that on mileage scales there is non-compensatory rates. that is the purpose of it?
- A. Well, I think the purpose of it was a little broader than that. The purpose was to show that when you consider the classification rating plus a class rate which not infrequently happens that on the lower classes and in certain lengths of haul with customary shapes of rate scale you do run into some non-compensatory situations.
- Q. At page 16 you said the purpose of this was to show exactly that, to show on mileage scales



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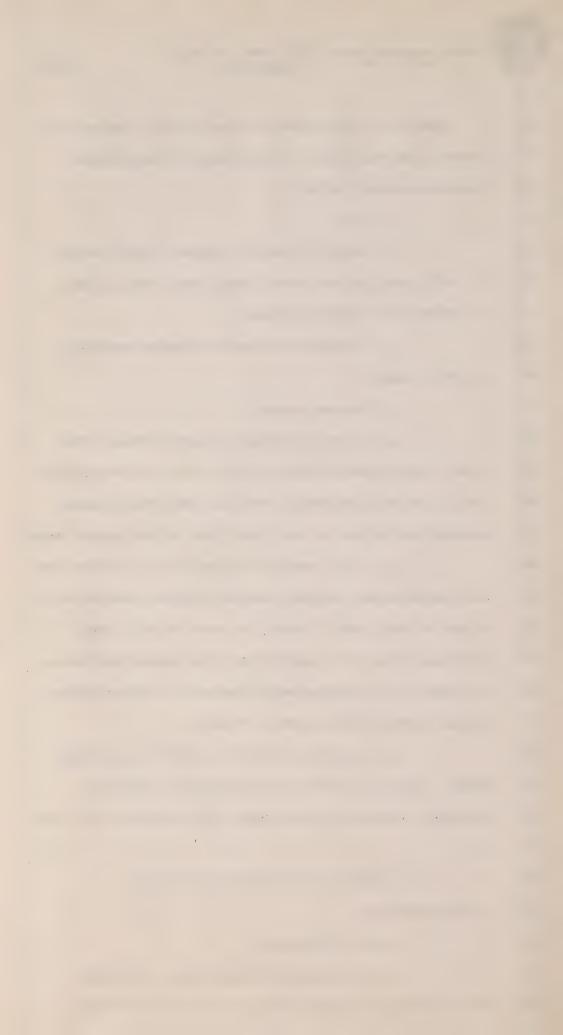
tradionally developed, as you put it, that on the lower class and on the longer hauls it resulted in non-compensatory rates.

A. Yes.

- Q. Under the United States classification, Dr. Williams, in the lower class, the lower columns, is there not a higher minimum?
- A. You are referring to minimum weight or minimum charge?
  - Q. Minimum weight.
- A. Oh yes, ordinarily that is true. The lower class normally are used only for carload traffic and it is very frequently the case that the minimum weights are higher in the lower than in the higher class.
- Q. I am looking at appendix "B" and you are dealing with the carload cost and you are dealing with class 50 and class 30 where you seem to fall into trouble, class 30 in particular, the longer distances. Now, what is a minimum weight under the United States classification for column 30 traffic.
- A. On column 30 it would not be a uniform thing. We would have minimum weights, generally speaking, probably higher than 20,000 pounds on a class 30.
- Q. Have you checked the Canadian classification?

A. No. I have not.

Q. Well, generally speaking, and rather than looking it up and giving it to you -- if I am





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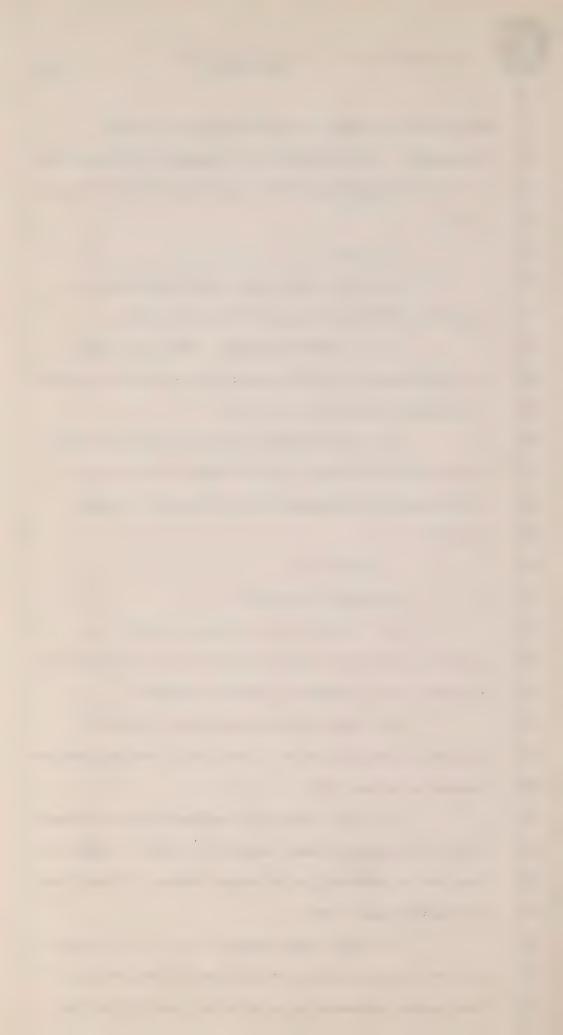
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isstate it	I am sure the traffic	adviser of t	he
Commission	will correct it	generally sp	eaking with
one or two	exceptions which are	around 30 th	e minimum
is 36.			

A. Yes.

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- And on that basis this would have a material effect on the impact of your column.
- A. Of course it would. That is to say, if you substitute 36,000 pounds you get quite obviously a different result on a class 30.
- Q. And, therefore, when looking at mileage scales it is important that we move in the columns from column 100 downwards to consider the minimum weights.
  - A . Quite so.
  - And it is also --0.
- I think it is obvious from the .... points Mr. Brazier brought forth as to the relationship between costs at differing minimum weights.
- Q. Under the Canadian classification I suggest to you that your 10 ton load is not appropriate except in column 100.
- A. Well, this would suggest that a different kind of analysis perhaps ought to be made in order to show the relationship with a cost scale. I think that is probably quite true.
- Q. And I also suggest to you, Dr. Williams, that this consideration of cost and mileage scale at the longer distances is a matter of considering the



page you say

taper on the longer distances. I would also suggest
to you that in the classification in Canada this has
been gone into to protect the very thing that you are
afraid of and that is non-compensatory rates from the
longer hauls.

- A. This may well be true. There is also, of course, the point on which I think I had something to say at an earlier proceeding here, that there is some question whether the straight line cost function which is asked by the I.C.C. is a correct representation of the behaviour of line haul costs with operations in distances.
- Q. Of course, traffic people are quite competent and capable of research and checking out these scales and objecting to them quite easily in this country if they find them non-compensatory.
  - A. I would assume that they ought to be.
- Q. Well, you are not suggesting that from your knowledge of the Canadian Pacific traffic and costing sections that they are not competent?
  - A. No, I would not suggest that at all.
- Q. And it is to their own self interest to make sure that their mileage scales are operating properly in regard to compensatory rates.
- A. That is what I have suggested at several points here, I think.
- Q. Now, Just another point; on the next page you say:

"Further complications will appear where, as



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in Canada the network of improved highways is not yet comprehensive."

I suggest to you that this is a misconception of a person who is not knowledgeable of Canadian situations and its network of highways. This might have been right five ....

THE CHAIRMAN: On what page?

MR. SINCLAIR: Page 17. This may have been right five or even asshort a period as maybe ten years ago but it is not a situation that exists in Canada today. Let me give you these examples.

A. Well, of course, I cannot say what the highways conditions in Canada may be but I would point out that there is involved in this question of the effectiveness of motor carrier competition not of the expense of highways merely but their condition, the traffic conditions that exist over them, the weight limits that may prevail and quite a variety of circumstances. Therefore, one must take a pretty careful look at what it is capable of for a highway operator to perform under the highway conditions on that basis. We have had quite considerable differences in unit costing truck operations in different parts of the United States attributable partly, and sometimes very largely, to differences in highway conditions. Most of these situations are now being mitigated by highway improvement. In the past the impact of truck competition in some sections of the country has been a little less onerous than in others. We have had



differences in the cost of tractor trailer carrier in highway operations ranging from  $35\phi$  in some places to as high as 56 or 57 cents in others.

- Q. This is quite often a question of density over the highway where the unit cost on low density are higher than those on the railway? Correct?
- A. I do not quite follow that since traffic at least in our economy is under no obligation to bear any more of the costs of the highways except to pay their excise tax, his consumption of gasoline and registration of the vehicle.
  - Q. You have no weight distance tax?
- A. I think we have in four states at the present time. On the other hand, the density of traffic does have an effect on him in the sense that with conditions approximating adjusting your heavy usage on a highway facility he will find his crews on overtime and he runs into added expense. He also has an additional factor in regard to his vehicle.
  - Q. That affects his unit cost per ton.
  - A. Well, the permissable load --
  - Q. For the size for the permissable load.
  - A: You mean the size limits themselves?
  - Q. Yes? A. Yes, he has a problem. This is true in
- most states in the United States and is a rather interesting problem in some states of adjusting the cubic capacities that he can get as the result of size limits to the weight limit that he is permitted under the law to handle over the highway and try to



exercise this under these limits.

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Q. I am suggesting and I think you will agree that the unit cost per ton mile on a movement by highway has marked differences where the vehicle has a load weight limit of five tons as compared to ten tons.

- A. Oh, yes.
- Q. This is one of the great density factor problems in trucking.
- A. Yes. I did not quite understand what you were pointing out. This is certainly true. The load of the factor is perhaps the most strategic single factor that affects unit costs on a truck operator apart from the question of whether he has a balanced load in both directions which is closely related.
- Q. Now, there was one other question that I wished to put to you and this was a matter just to clean up. There has been some discussion here and it was continued with Mr. Brazier asking some questions yesterday concerning the position of the value of the commodity in classification. I am going to read from the 2300 series class rate investigation in the United States on this matter. I am instructed that this is a proper quotation even though I am taking it from a text. I will read this to you:

"Development of competitive transportation agencies with flexible service, and a disregard of the element of value by the competitive agencies in the determination



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of their charges, have reacted upon the policies of the classification committees with the result that generally weight density is now the dominant consideration in determining classification ratings. This does not mean that value and other principles of classification are completely eliminated from consideration; but it does mean that value of an article does not control the rating to the extent it formerly did."

That is a quotation from class rate investigation, 1939, 262 I.C.C. 447 at 482. You agree that is a fact?

A. I think that is a perfectly correct statement but a full understanding of its impact perhaps require two comments. The first one is that what is referred to is a shift of emphasis and admittedly it has been quite a considerable shift of emphasis. There is no doubt about that, unquestionably the weight density has played an important part. Secondly, of course, it has played a part as far as the reports of the classifications have actually come forward and have been considered by the classification committees, that is the practice, looking forward to representation as we go through that process from day to day.

Q. Did you know that there had been a complete revision of the classification in recent years in Canada?

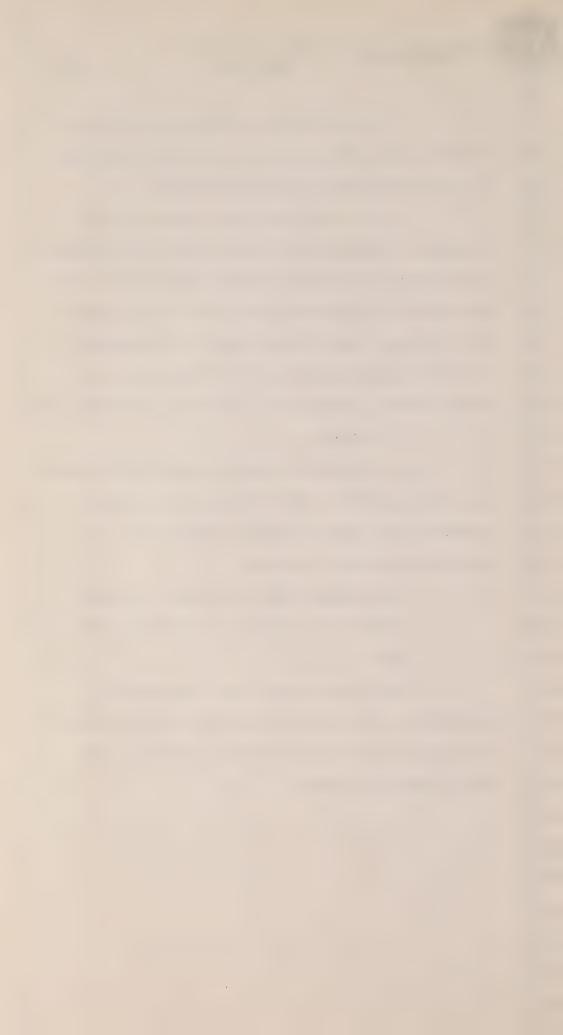


	Α.	No,	we had	one	in the	United	States	but
I was	not aw	are th	at you	had	one in	Canada.	. We ha	ed
to do	so whe	n we h	ad our	283	00 pros	esding.		

- Q. You know that these classification
  hearings, classification considerations, that shippers
  come before the committee, express their views. They
  present their problems and they deal with the matter
  in a practical way of moving traffic and looking at
  it as to reclassification on the determination of
  moving traffic. That is the motivation of classification?
  - A. Quite so.
- Q. On page 19 there is a point that struck
  me. You are dealing with the manufactured tobacco
  products and on page 19 you say, speaking of
  manufactured tobacco products:

"The greatest part of a traffic in this commodity had, however, already been lost by 1946."

Mave you considered the situation of manufactured tobacco products on the Canadian railways as compared with that unfortunate situation to the United States railroads?



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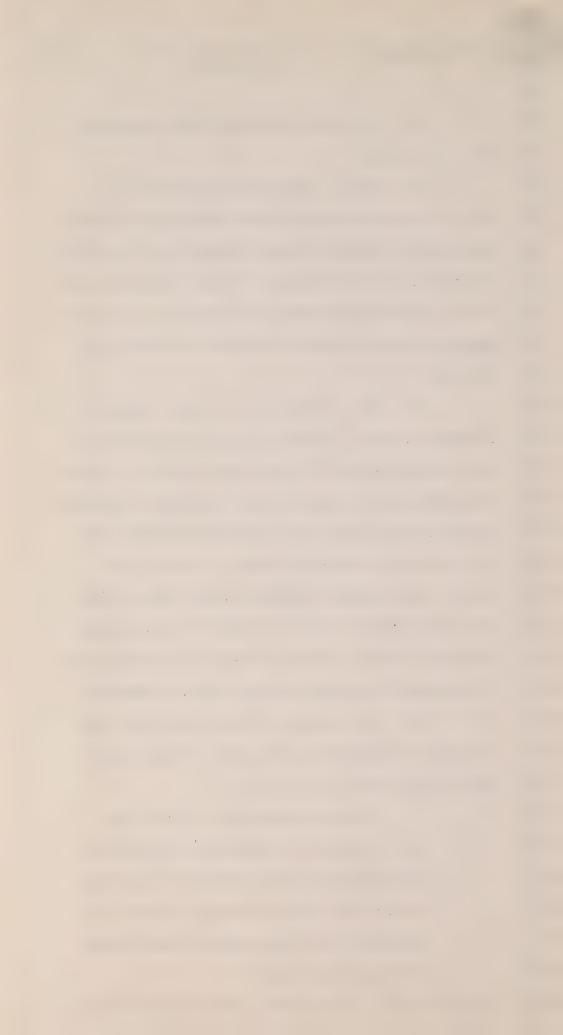
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A. No, I don't know what your experience with it has been.

- Well, I suggest to you that if you check it out that you would find manufactured tobacco products are covered by agreed charges with very high proportions for the railways. Would you agree with me this is an example where the railways by the use of agreed charges are able to show their economic advantages?
- A. Yes, I think so. If your suggestion is similar to ours, in many of these proceedings in which the railways and trucks were involved in controversy about these tobacco rates, it was quite apparent from the cost evidence put in that the railways were by far the more economical method of moving this traffic, and I think, therefore, that a device that would permit them to retain it would be an excellent situation, not only for the railways but generally for the problem of allocation among forms of transport.
- Q. Dr. Williams, before I deal with the principle of your brief, I have two or three small points in your text. Page 24:
  - ". . . the railroads have not yet seen fit to suggest a comprehensive revision of rate structure which would give expression to the cost characteristics of their own industry and to the nature of the competition which they face."

I suggest to you, Dr. Williams, that in Canada through



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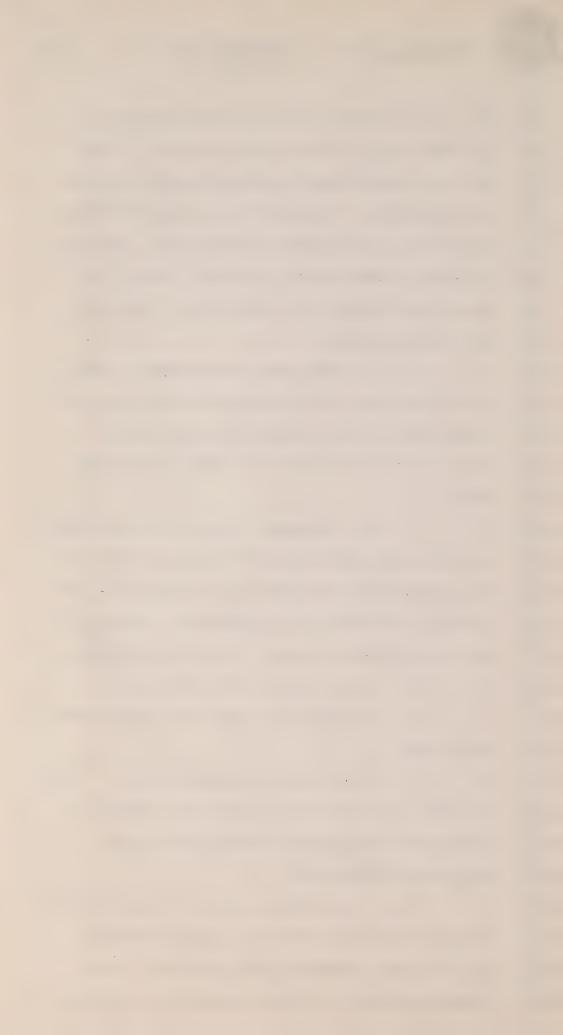
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the use of competitive rates so marked, which is different than the United States situation -- that these are tariffs marked competitive and do not apply to intermediate --- through the use of agreed charges; through the use of loading incentive rates, that the railways in Canada and the regulatory climate has enabled the railways to do what you are suggesting here: would you agree?

- A. I would agree to the extent it seems to me quite obvious the Canadian railroads have gone further than our own and that the agreed charge device has been very helpful to them in that connection.
- Dr. Williams, arising out of that would Q. you agree that obstacles to the expansion of one form of transportation into others must be removed if an effective integration is to be secured -- and so we won't go through this again, I am using your words.
  - Yes, I recall that proposition.
- Q. You have not changed your mind on that since 1959?
- No, I have not changed my mind. I was Α. under the impression, though, that your railways in Canada had already greater freedom than our own carriers in that respect.
- Q. I was going to ask you if you knew that Canadian Pacific had introduced a pilot operation which has been expanded to some degree of a fully integrated truck-rail economic shift in the Province



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of British Columbia?

- A. I have heard something about it lately, but I am not familiar with it.
- Q. Now, on page 25 you are suggesting that there is an excess of rail capacity in comparison with present and prospective traffic. In view of the extractive industry importance in the Canadian economy, have you considered the impact on, for instance, Canadian Pacific of the development of potash and sulphur and the by-products of the new petroleum natural gas industry of western Canada on prospective tonnage on the railways?
- A. If by "considering it" you mean measuring it, I have not; but I have been aware there was much development of that kind going on, which should certainly produce productive tonnage for the railways. It should be part of a process by which such excess capacity as there may be is tending to be reduced.
- Q. So, you are not trying to say to this Commission you are making a judgment or an analysis of potential traffic in respect to Canadian Pacific and saying ---

THE CHAIRMAN: I think Dr. Williams does not pretend to be familiar with the systems of Canada.

Is that right?

THE WITNESS: That is correct, yes.

MR. SINCLAIR: Q. Now, Dr. Williams, I wish to deal with what I would call the philosophy of this paper in regard to the rate structure and pricing, and



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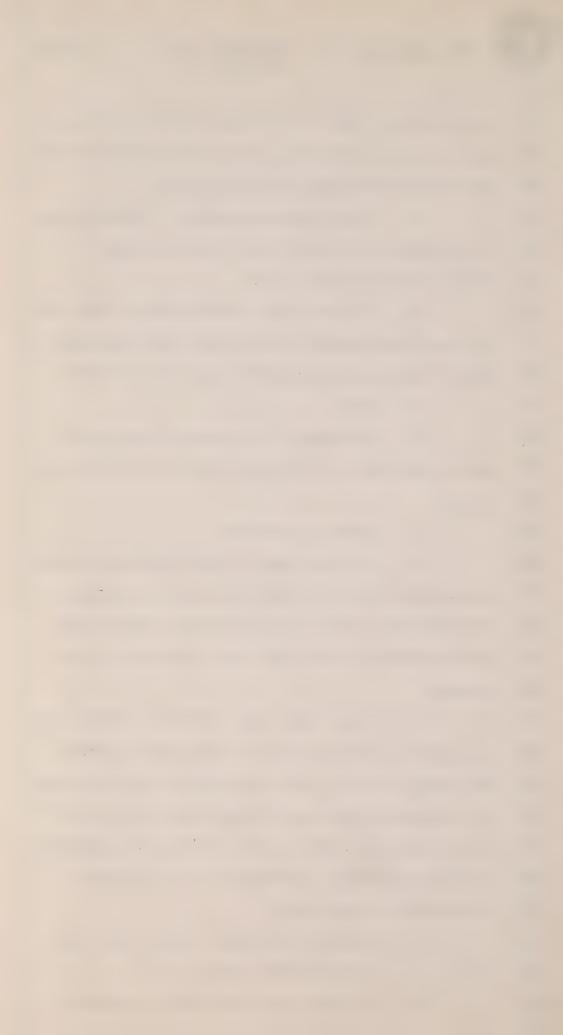
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I would ask you this -- by the way, so that I will know how to direct my questions, are you an economist of the so-called Welfare school, or are you not?

- Well, not particularly. I studied some of the Welfare literature, but I certainly don't describe myself in those terms.
- Q. In considering transportation, under the tree enterprise system would you agree that reasonable market controls are superior to regulation; correct?
  - Yes.
- And basic to your theory of pricing is that no rate will be maintained below its variable cost; correct?
  - A. That is quite true.
- Q. And also basic is that competitive rates should not be used as a base upon which to construct non-competitive rates, or to be used as a test of the reasonableness of rates where the competition is not present?
- A. Well, that last, not quite. What I have suggested is that certainly our principles in testing the reasonableness of rates have made it the case before our Commission that competitively compelled rates, if used in such comparisons, carry little if any persuasive powers and generally are not held to be relevant to a comparison of that kind.
  - Q. You would not argue for any other rule?
  - That is what I said.
  - Q. And that they should not be used as a





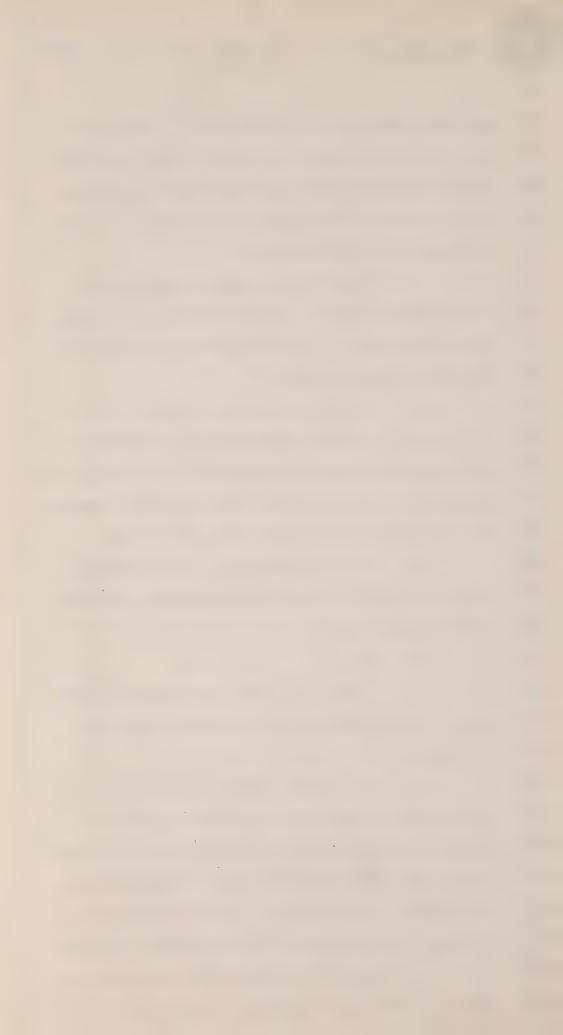
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base upon which to build other rates -- that is the other part of the basic proposition -- they should not be used to test reasonableness where that competition is not present, and they should not be used as a base upon which to build other rates?

- A. I don't know I could subscribe to it
  in such general terms. I suspect there may be exceptions to that case. I am not sure I fully understand
  the sweep of your question.
- Q. Let me give you what I have in mind: if we are going to take a situation in which they are going to consider the fixing of maximum rates by principle or in any other way, that a base rate upon which a mark-up was to be used should not be a competitive rate?
- A. If I understand you, you are referring to the process by which one should determine the level of the maximum rates?
  - Q. Yes.
- A. I find it a rather unsatisfactory thing to try to make a mark-up on a competitive rate for that purpose.
- Q. Dr. Williams, the next point that I wish to put to you is this, that differential pricing by railways within the limits of variable cost as a floor, and the cost of an alternative mode of transportation as a ceiling, can give you no cause for complaint as resulting in misallocation of transportation resources?
- A. Well, I have never felt there was very much danger of it in a situation of that kind.

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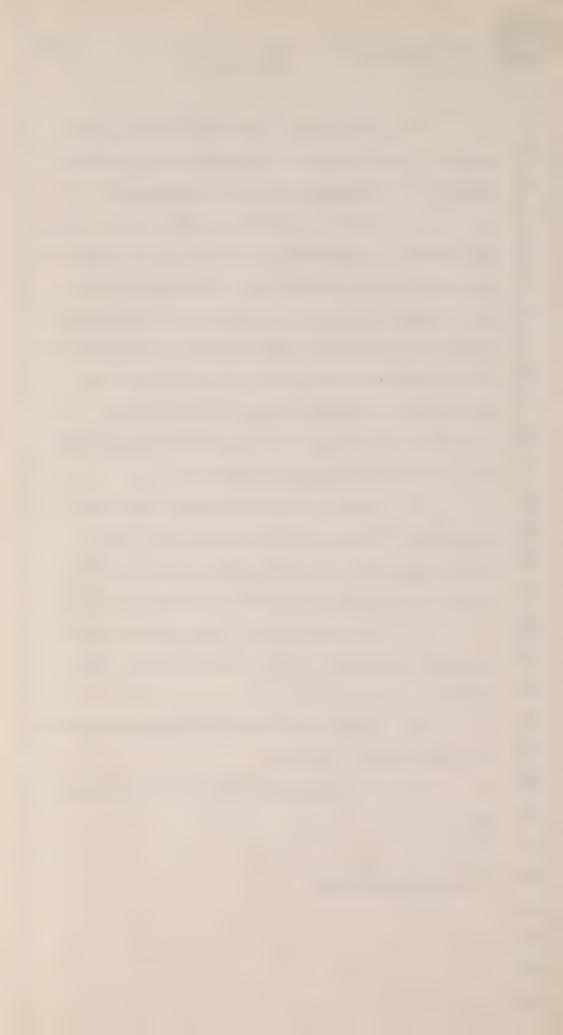




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- Q. I suggest to you that measuring value of service by the cost of an alternative means of transportation is a reasonable method of measurement?
- A. Well, I wouldn't say that it is a reasonable method of measurement. It seems to me that it is the measure of the value of the service when we deal with a competitive situation where we have alternatives. I never thought it was a very reasonable measure of the value of railway service back in the days when our Southern Pacific Company charged local rates in California at 15 cents a ton mile on the grounds that was the cost of wagoning over the road.
- Q. Well, if you are going to follow the allocation of transportation resources in a true economic way, that is exactly where you get, isn't it -- because, if the only alternative is the wagon ---
- A. But this is one of the reasons why we introduced regulation of the railways in the first instance.
- Q. This is maybe why you introduced them in the United States, you mean?
- A. I am speaking about the United States, yes.
- ---Luncheon adjournment.





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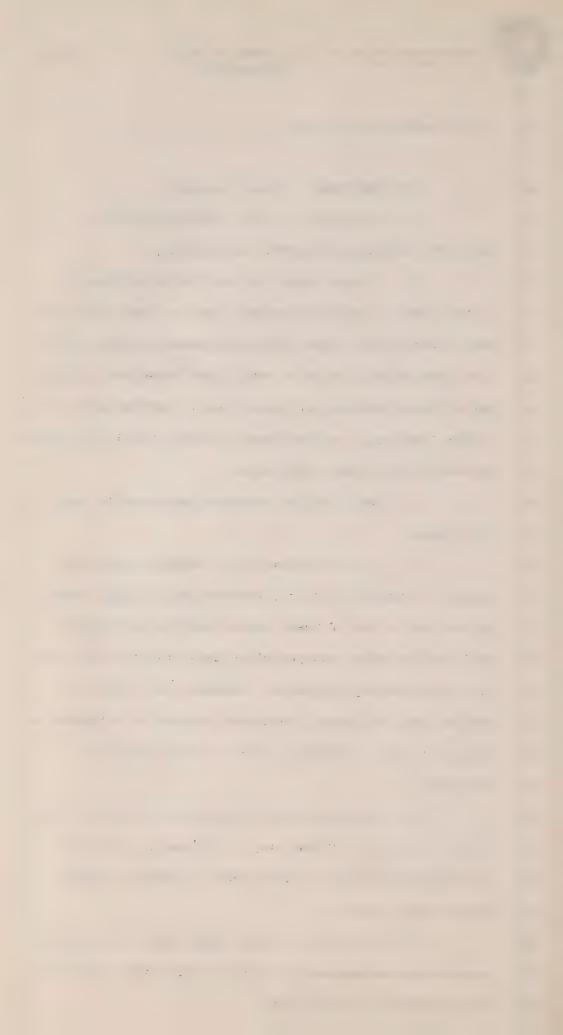
--- On resuming at 2 p.m.

THE CHAIRMAN: Order, please.

MR. SINCLAIR: Q. Dr. Williams, do you advocate minimum rate control of trucking?

A. I have taken the position with respect to that that in view of the fact that we have had it in the United States since 1936 and operated under it for some considerable while we would have ourselves another one of these problems of transition in getting out of it. In the long run, I am inclined to think that it is neither necessary nor perhaps desirable.

- Q. Well, do you advocate maximum rate control for trucks?
- A. I do not know of any reasons that would compel it, except in such circumstances as might occur, and we have a few of them, where trucking operations would be the sole transportation available at some points or in some areas, and where, likewise, we, under our present law, of course, have what amounts to a franchise vested in one or perhaps a quite limited number of carriers.
- Q. As long as you have franchises or limited entry, let us put it that way -- as long as you have limited entry, you are saying that you would require maximum rate control?
- A. Unless it be true that there is effective competition between motor carriers and another form of transportation, such as rail.

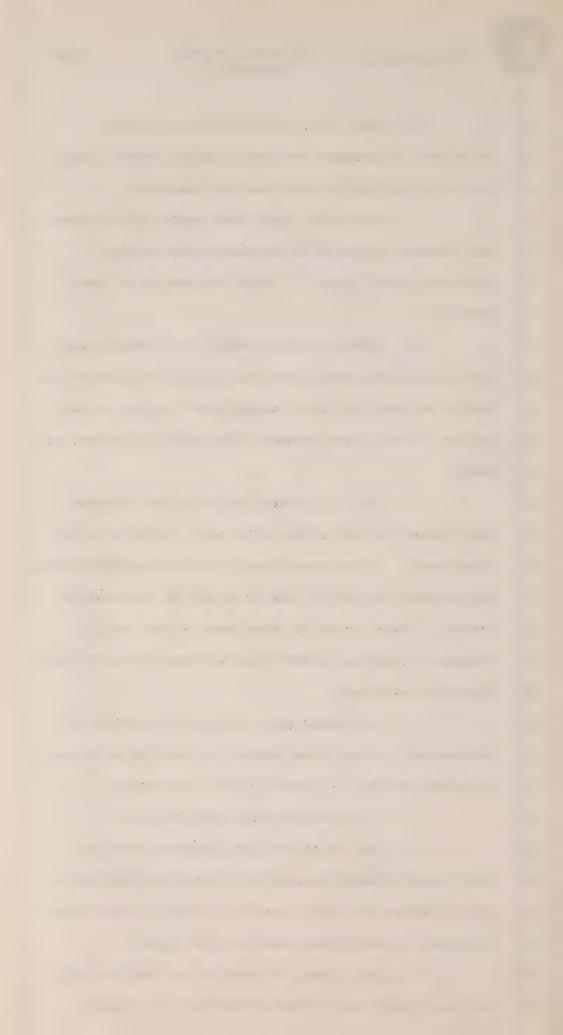




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	Q.	Well	, D	r. Wi	lliar	ns,	hov	V	vould you	
calculate	the	maxi	mum	rate	for	a	truc	k	operation	that
was to be	app.	lied	to	more	than	on	e or	er	ation?	

- A. You mean a rate that would apply between two points, but would be applicable over several competing truck lines? Is that the meaning of your question?
- Q. That, plus the fact that it would apply not only between two points, but across the country, or within an area that is of significant degree let us say, for half the country? How would you arrive at that?
- A. Well, I do not know that the occasion would arise for us to deal with such a thing on a very broad scale. If we were compelled to fix maximum rates, and we have very seldom had to do so, in the case of trucks, I think we would there want to look at a trucking situation in very much the same way as we would look at a railroad.
- Q. And would your answers in relation to minimum and maximum rate control on trucking also apply to water carriers -- coastal and inter-coastal?
  - A. I do not see any reason why not.
- Q. And would you also advocate that you would have legislation similar to what you have in the United States that would prohibit foreign bottoms from engaging in coastal and inter-coastal trade?
- A. Well, now, it seems to me that the drift of these questions is kind of shifting our ground. I





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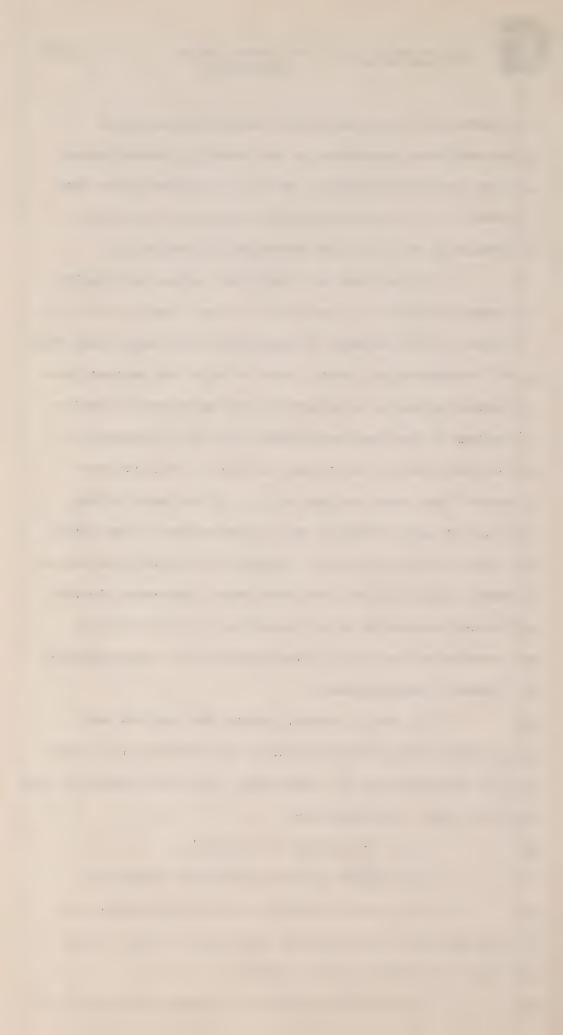
I do not think we can allow economics to take the whole stage when we have lots of other things to which some weight has to be given.

Q. Now, Dr. Williams, I suggest to you that no

started by talking about the possible necessity of maximum rate regulation in the trucking industry under some limiting conditions. And it is certainly true that there is a close relationship between the matter of freedom of entry and the necessity to regulate it.

If you have got restricted entry, and you have franchise rights of some kind or other, then you do, of course, in the absence of competition from some other form of transportation, have a case in which the maximum rate regulation may be a necessity. The question of foreign bottoms in the coast-wise trade with us is unhappily a very complicated one because of the rational defence aspect that comes to bear on it. If one were to talk about it with reference only to the matter of the public benefit as related to the transportation functions per se, then I would say that our coast-wise laws which exclude foreign tonnage do us a dis-service, but we have not governed our coasting policy primarily by transportation economic considerations.

- Q. Well, actually nobody has applied and governed transportation policies by economics in a sense that economics was the number one, and other considerations were lesser considerations?
  - I think that is correct.
  - And you would not advocate otherwise? Q. \_





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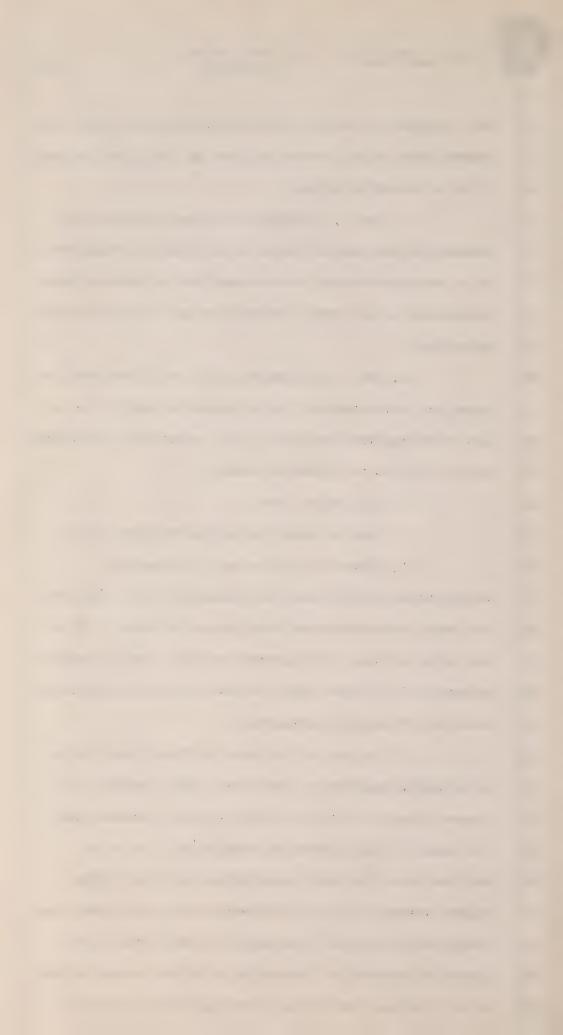
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rail shipper has a just cause for complaint if his rates approximate or fall below the cost of moving the traffic by an alternative media?

- A. Well, I think that depends entirely on whether we are talking about an alternative media that is a reasonable substitute or one that is such a remote substitute as not really to provide any control on the situation.
- Q. Well, in economics, Dr. Williams, who is going to decide whether the alternative mode is or is not providing what you call a real substitute? And this word "real" is in quotation marks.
  - Oh. quite, yes. A.
  - Who is going to decide this question?
- A. There are, after all, degrees of substituting ability and they shade off into some that are very remote and some that are quite close. I do not think we have any recourse except to rely on public authority to do that where we have issues of this kind that are of public consequence.

It is part of the kind of thing that led us into public regulation. We were in the posture, of course, where the railroad made a faster advance over the kinds of transportation available to us at an earlier time. So that competition, at least, with inland transportation by highway in the period when our regulatory structure commenced to come up was in no sense an acceptable alternative as either respects the quality or cost of service, and therefore placed no



concerned.

Q. Dr. Williams, if as a real substitute,
or what is the economist's definition of effective
competition is going to be decided, we can agree that

limitation, was in the least acceptable either on

economic grounds, when it comes to the question of

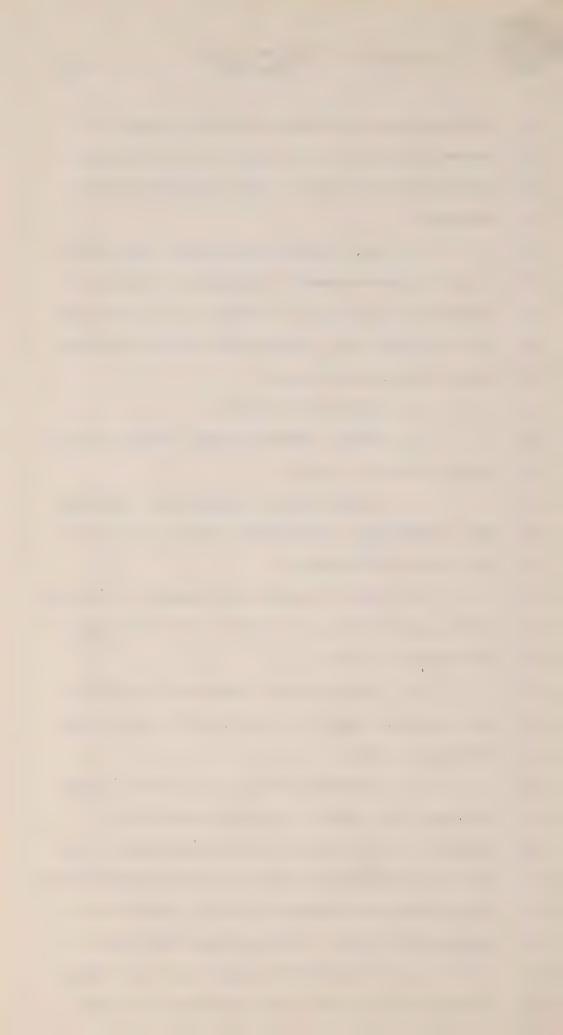
A. No question about it.

fought issues between people.

Q. And we cannot with any certainty rely on definitive tests; correct?

this is going to be a question that raises many hard-

- A. I think that is generally so. Any tests that we may have, I would think, have to be applied with a degree of judgment.
- Q. And in fact the last judgment of any rate is the effect of it in the market? You would agree with Ripley on that?
- A. Oh, yes, except that when you get into that situation, again, you have something that is very difficult to test.
- Q. And even after you get in there, you do
  not know, and I suggest to you you cannot say in
  advance -- not only you do not know subsequently, but
  you cannot know perspectively the demand characteristics
  for all the myriad movements that are covered by any
  given group of rates? Would you agree with that?
- A. I think that is generally true, although
  I think it is also true that with respect to a good
  range of substantial traffic movements it is possible to



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make some fairly decent estimates or guesses. They are not certainly definitive and they may be proved wrong by the subsequent event.

- Q. But the proof of them being wrong can have a tremendous leverage on the financial stability of a transportation company, such as a railroad; correct?
- A. Very easily, if what we are talking about is in a magnitude of consequences, traffic-wise.
- Q. Now, Dr. Williams, in Canada the railways must be able to show that competitive rates improve the net revenue of the railway and the same is applicable to agreed charges, and in view of the well established tradition in this country in rate making, that a rate must more than meet its variable cost to be just and reasonable, I suggest to you and ask you if you would agree, that there is possibly equalization area-wise alone and no other means for maximum rate control in this country for rail transportation?
- A. I am not sure I quite get the burden of your question?
  - Q. Let me put it again.
  - A. Yes.
- Q. In Canada, competitive rated traffic, whether it be competitive rates or agreed charges, the railways have to be in a position to stand the test that these rates have improved the net revenue position of the railway to be able to meet that test?
  - A. Yes.
  - Q. And in view of this, plus the well



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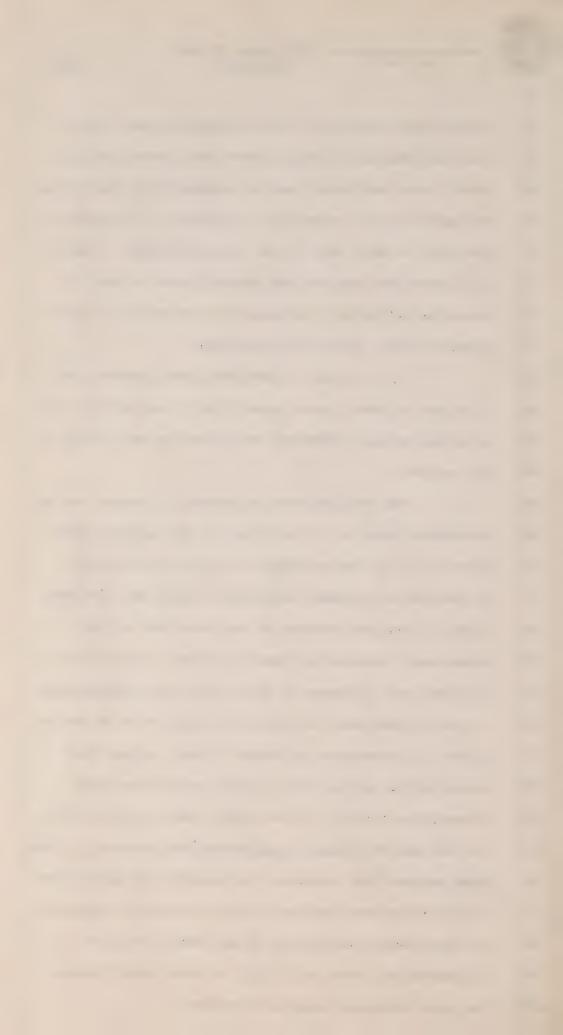
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established tradition in this country, Canada, that just and reasonable rates, other than those specific that I have mentioned, must be compensatory, meet their variable cost and something in addition, I suggest to you that -- and I ask you if you would agree -- there is no need for maximum rate control, with a possible exception of having a maximum range of rates for area equalization? That was my question.

A. I think I understand your question now. I do not believe I would agree with it in that context as being entirely adequate to express my own feeling in the matter.

The freight rate structure, of course, as the economist looks at it, is a part of the general price structure. It has certainly an influence upon the allocation of economic activities within any territory where it has application; it has some bearing and sometimes a substantial bearing on what resources will be developed, on where it is possible and appears wise to make investments in productive enterprise of various kinds; in consequence of which it would appear that unless where one has what I would refer to as noncompetitive traffic, in the sense there is not at the present any real close economic substitute available, there were maximum rate controls, the possibility would seem considerable that resources that it would be desirable in the economy to develop, if the rate structure reflected the costs, will fail of development because the rate structure departs therefrom.



There is, in other words, an allocation question, as the economist sees the problem, that is broader than the question of allocation among forms of transport, and that is what is the influence of the freight rate structure on the location and development of economic activities.

Now, this, I think, has some bearing on what you say about territorial equalization, but I would think that it had to apply not merely to the relationship of broad territories one to another, but rather to individual points as well.

Q. Well, Dr. Williams, let me see if I understand that answer. What you mean is this, by that answer, that as soon as you find traffic -- and you have recognized that this may be difficult to determine -- that has no true substitutionality with respect to modes of transportation, this then raises the question of the need for maximum rate control; is that right?

A. For which there is no reasonably direct and acceptable substitute, yes.

Q. Now, the only reason you say that that requires maximum rate control, according to your answer to my friend, Mr. Cumming, yesterday, if I understood it correctly, is because it may result in that traffic that has no substitutional mode of transport bearing what? A more than reasonable share of the transportation burden? Is that your position?

A. Well, this does not necessarily come down to a question of what is reasonable. If one keeps



situation, and I think we have had examples of it in the United States — I do not know whether it is true here — where because of the existence of competition you get a reduction in the applicable rate structure, and especially in the industries where the freight rates are of some considerable importance as to the growth and opportunity of the industries affected. You tend to put the development of industries under somewhat a forced draft under these circumstances and place obstacles in their way if rates in other parts, if an effective substitute has not appeared, are allowed to depart substantially in an upward direction.

The question of reasonableness, I think, arises in a little different context than that, but the problem of economic allocation, I think, is certainly an important one for any country which is interested in considering its overall development.

Q. Yes, Dr. Williams, but there are two points which come out of that answer and maybe I can take the last one first. Under our economy, we do not control maximum costs of labour?

A. Quite.

Q. And other costs of production; and these all have a bearing upon all these economic allocations and re-locations and use of labour and materials that you have been speaking of, and yet, not withstanding that, you would not advocate a completely regulated economy, I take it? You would still say that you must



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regulate one factor in the price mechanism of location?

- A. I would like to, as a matter of personal and professional feeling, get away from regulation, just as much and as fast and as far as I could, but the difficulty is that we bring regulation in as a tool precisely because we get into situations where we have present a degree of monopoly power, as the economist likes to call it, and we would consider ourselves free to begin to depart from such a regulation when that disappeared. Consequently, the distinction between the presence and the absence of effective substitute is, to me, a very important one.
- Q. But there is elements of economic monopoly power in this country. I do not know about the United States maybe as well as you do, but let us take Canada.

  There are elements of economic monopoly power in labour?
  - A. Of course.
- Q. In patents; in processes. Are you suggesting that because of that they should be regulated and their maximum charges fixed?
- A. Well, I think as a general proposition one would say that in the public interest, when you have monopoly elements, almost of whatever sort, the effect of which is to permit a monopoly exaction against the public, then you have an argument for regulation. You may have an economic argument, but of course you may, by political impractibility, which is something else again --
  - Q. Let us not get in yet to the political



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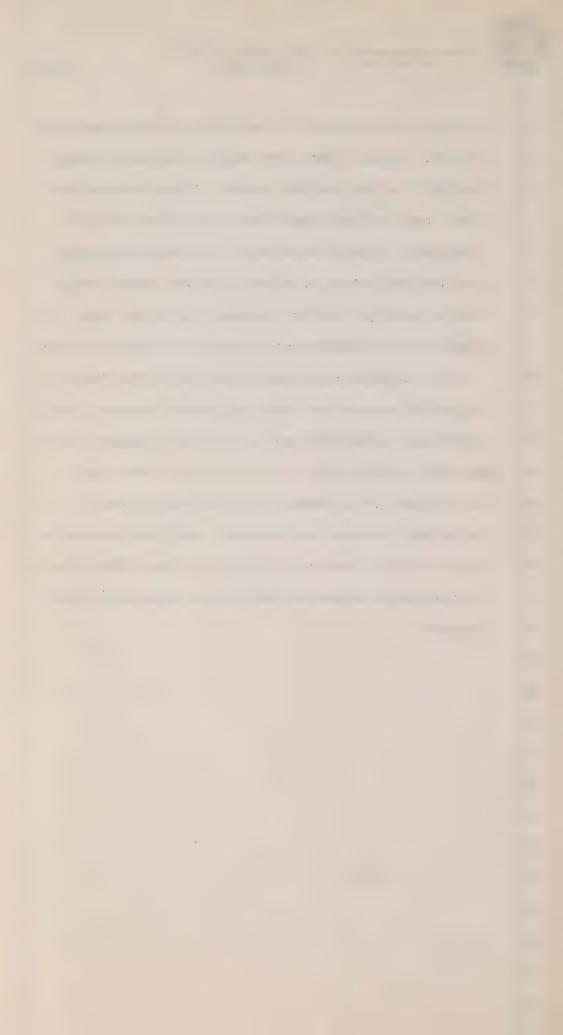
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factors, Dr. Williams. I am trying to understand the economic factor. This goes back to the second point you made in that earlier answer. I have covered the last one, and the other one was that you used the example of a competitive rate being instituted which you said would have an effect upon the traffic which had no, what you called, economic substitute mode. But that is why I pointed out to you the difference in this country, between this country and the United States, in regard to competitive rates and agreed charges. And, with these safeguards now in our law, I suggest to you that while you may need it in the United States you do not need it in Canada, and I am talking about individual maximum rate control. Has that occurred to you, that this problem in Canada had been taken care of by the law in regard to competitive rates and agreed charges?



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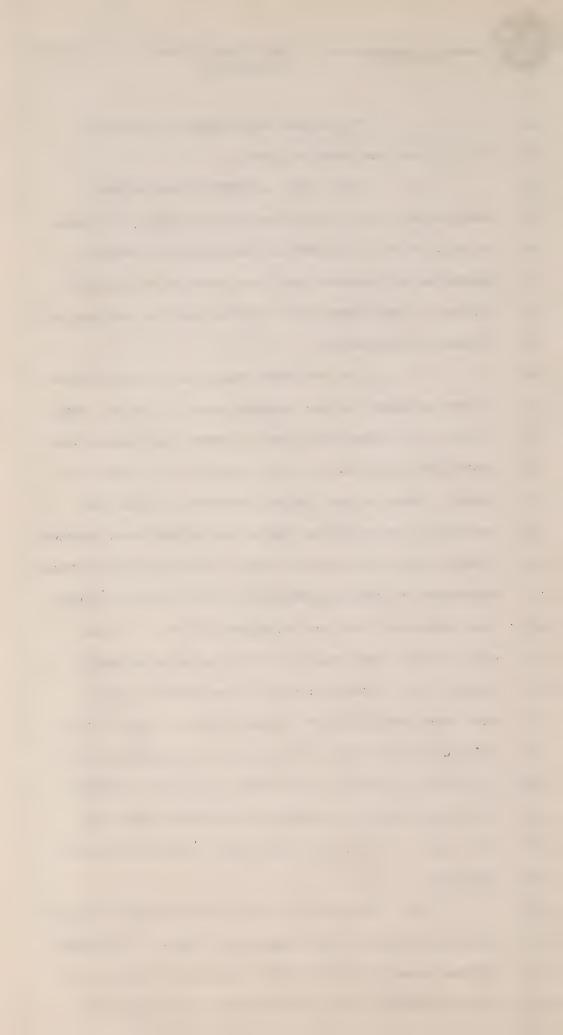
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A. No, it had not occurred to me and I still do not see that it does.

- Q. Well, then, if each of the agreed charges and each of the competitive rates by law must be able to meet the test of increasing net revenue, improving net revenue, how can there be a burden by virtue of that thrown upon traffic that has not got an economic substitution?
- A. I do not think there is any burden cast by the incident you are talking about. I do not think I have ever argued there was a burden cast by any such individual incident or even a collection of such incidents. What we are finding, however, is that the variety of pressures, including the inflationary pressure. trend to force the traffic that as yet has no acceptable substitute to take a good part of the increase in the cost structure that come along, and so on. If you were talking about making a new rate broam agreedee? charge or a competitive rate in the normal course that rate itself either retains traffic, either it is threatened with loss or it develops new traffic, and it is not of itself a rate that contributes something over its direct or alternative cost as we might use I do not see that that casts a burden on the term. anything.
- Q. The point is this; harsh though it may be and harsh though it may become, the facts of the matter are that some of the low rated long haul traffic which has been ætting cross subsidization from high rated



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traffic just cannot get it any more because the railways are not able to charge on that high rated traffic
the level of rates that permit them to maintain the
low rate to the degree that they do on this other
traffic. It is an economic fact.

MR. MAURO: There has been reference on three or four occasions to the fact that in Canada we have this safeguard, that the competitive rate or the agreed charge must improve the net revenue of the railways. While I don't want any legal argument, I think it might be of assistance to Dr. Williams and also to the Commission if I could read what the legislation really says.

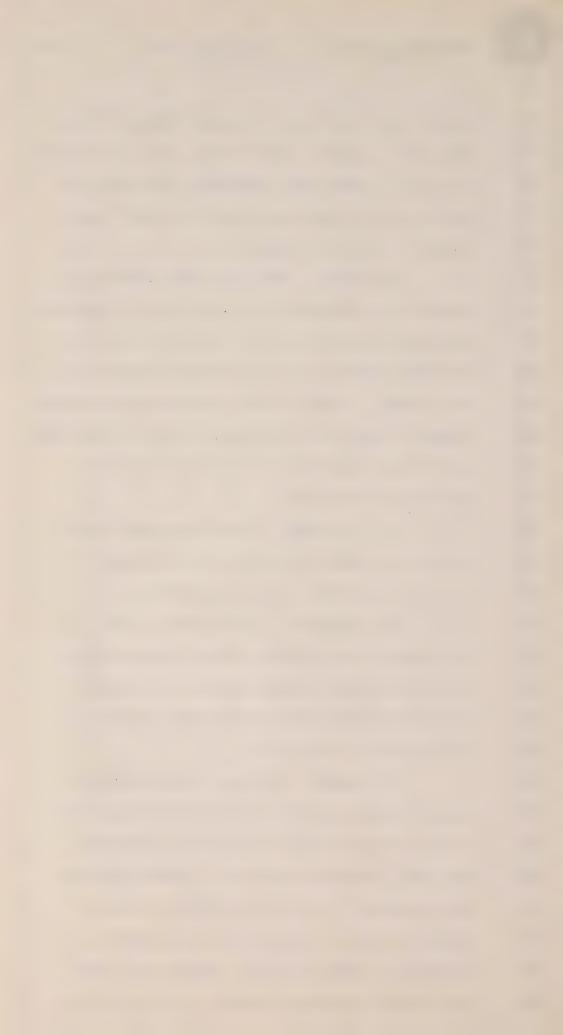
MR. SINCLAIR: If my friend says that is not the law I shall refer him to the section.

MR. MAURO: I have the section.

MR. SINCLAIR: I have the sections. I am objecting to my learned friend interrupting my cross-examination of this witness in this manner.

If the Commission wants to know where the law is I will say where I think it is.

MR. MAURO: The point is my friend is postulating his questions on an interpretation of a section of the Act, and I think it is important that that Act be both before the witness and before the Commission. In my humble opinion it says nothing, nothing about improving any revenues nor is there any check until the submission has been made to the lieutenant governor in council and the



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MR. FRAWLEY: It is a little more than

railways meet and then an investigation is made and it is to the effect that the making of the agreed charges is likely to have.

MR. SINCLAIR: Just a minute -- I feel very strongly that my friend gets up and says that to a witness like Dr. Williams, that Ian Sinclair, who has been in this business for quite a few years, has misstated the case.

MR. MAURO: I think the section speaks for itself.

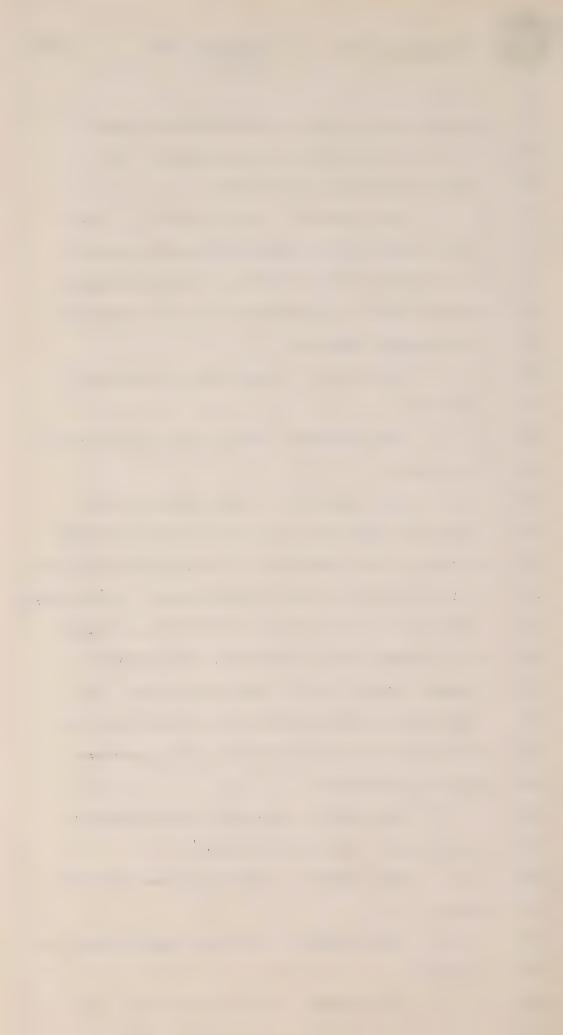
THE CHAIRMAN: There is not a question as to the law.

MR. SINCLAIR: I will just put on the record, Mr. Chairman, and say to my friend that when he says I do not know what is in this Railway Act and in the Transport Act that 1 am surprised. Section 334, subsection (6), the extent to which the net revenue of the company will be improved by the proposed changes -- that is No. 1, competitive rates. On agreed charges, the Transport Act, Section 33, "is likely to have on the net revenue of the carriers who are parties to it".

MR. MAURO: Where is it about improving any revenues? What is the effect?

MR. FRAWLEY: On the order that the Board

THE CHAIRMAN: We are not going to get into



semantics because this witness is a stranger from New York and I think he should have the whole situation stated to him before the question is put.

THE CHAIRMAN: This witness is very competent.

MR. FRAWLEY: But he does not profess to be competent about what is in the Transport Act of Canada.

MR. SINCLAIR: Q. Well, Dr. Williams, if I have misled you I am sorry, but I will say this to you, that the way I put the question to you is what I think is a proper interpretation of the Railway Act and on that basis I will leave it.

I now ask you this: in so far as there is no burdenput on traffic of which there is no substitution there cannot be in that traffic any complaint. You would agree with this?

A. I agree to this possible restatement which may be what you were just saying, or may not.

I am not entirely certain that when a rate is made the effect of which is to hold or develop traffic in the face of clearcut legitimate competition and that could, of course, be potential competition which is a thing which we have more and more to recognize, where the effect of that rate is to hold or to develop traffic, and it does so, in that process it, makes a net contribution. Then, neither that rate nor the traffic which moves under it, in my opinion, casts a burden on anything else in the railroad traffic structure.

Q. My question to you is this: in so far as

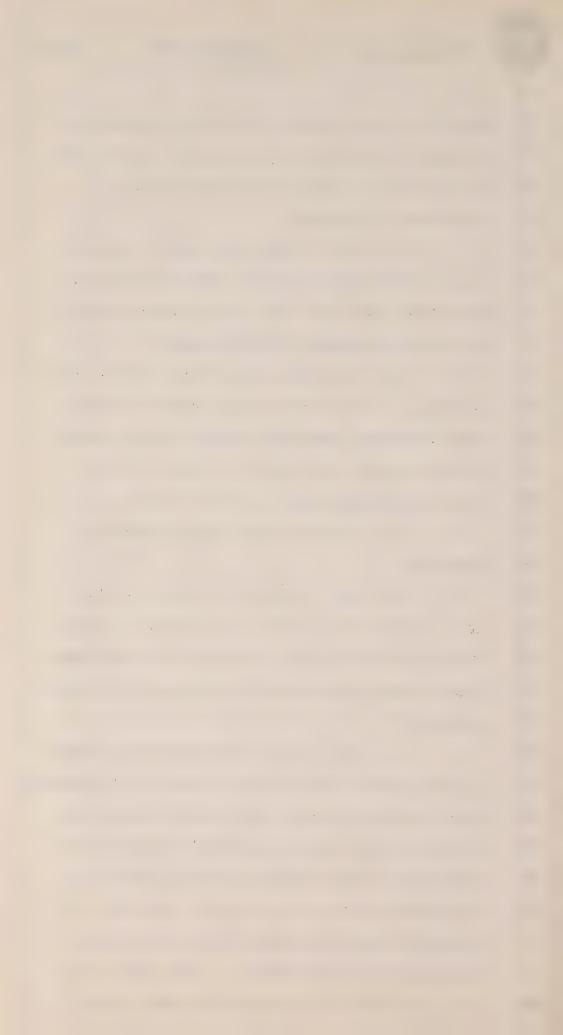


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there is no burden cast, in so far as regulation of railways are concerned, the shipper who is under what you term the near effective substitional has no real cause of complaint?

- A. Well, I would say he has no cause for complaint about the particular reduced rate that we are talking about, but this does not deprive him of the cause of complaint on other grounds.
- Q. I am sorry, but you and I are at cross purposes. He has not cause of complaint for his rates increasing from where they were before because of the allegation this traffic did make the same cross-subsidization that it did previously.
- A. I think he certainly has cause of complaint.
- Q. Why? Because the answer to it is if the railways do not get it through and as long as they are operating within reasonable efficiency where else can they get it unless it is going to be a state enterprise?
- A. This raises a question which I thought was the question I was trying to raise in the submission which I made as to where lies a solution which does not on the one hand by the gradual increase in the proportion of burden which may have to fall on the declining body of traffic would have the effect of solidifying the development which would otherwise be desirable for the country. This would have, I think, the effect of continuing increases on non-



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competitive traffic. There is the question that the economist, I think, would be inclined to accept. think he could not say with assurance without further examination that that would represent a disservice to the national economy as a whole. The question then arises that if it is a disservice is it so great a disservice as to justify some other means of carrying that burden other than to require it to be borne by freight shippers in the present fashion.

Q. But, Dr. Williams, it is basic to what you state here, that you must have it one way or the other. You cannot live half regulated and half not regulated, half slave and half free. Why do you think you could live half slave and half free with this economic application applying to only one section of rail transportation and not applying to the whole of it?

A. That is a very good question and one that has troubled us a great deal. Unfortunately, we economists as a whole have had to come to the conclusion that both the general structure of water carriers, for the most part, is of the kind that permits us to expect that if they were left unregulated we would get what the economist likes to call workable competition that would be fruitful, and generally would serve the public interest. We have on the other side of it the fact that the railroad enterprise shows different economic characteristics and structure and that under those circumstances we could not accept any



more than we in fact found in the past, that railroad

produce generally fruitful results. We are compelled

to make a distinction there because the railways, while

it certainly does not have all the characteristics of a

a cost structure and the kind that very often goes along

with conditions that carry with them, on the one hand,

an opportunity to discriminate and, on the other hand,

substantial reasons why in the interests of the carrier

discrimination should come about. We would anticipate

that if you had freedom of entry in the trucking

where entry into the trucking industry is a com-

that the competition would perform the function

industry, for instance, and under this highly direct

cost structure with limited overhead and a situation

paratively easy thing involving limited capital invest-

ment, that we would get competition by which individual

members got entry into and exit from that industry so

reasonably adequately, adequately enough so that there

The railroads are not an easy

would be no great need for public concern. Most

of these elements, you see, are not present in the

industry to enter because it is one requiring an

enormous capital investment. It is not an industry

that lends itself to competition of numerous carriers

between common points. It is not one from which

natural monopoly, it does have some, and it also has

competition when it was entirely unregulated would

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carriers can de easily expunged by the competition 29 process. We are left with the proposition that we do 30



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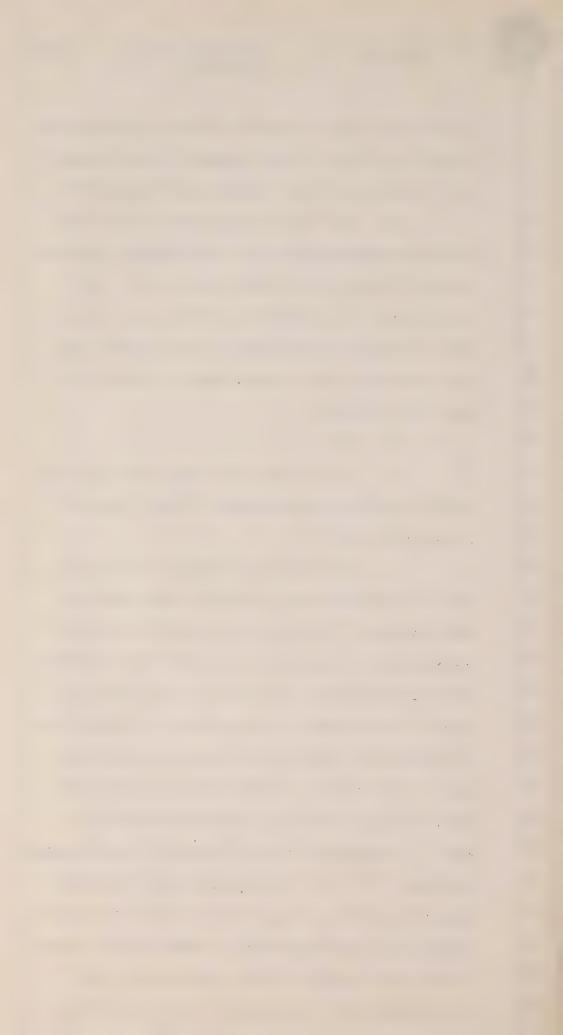
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not see that certain of these elements of prospective monopoly power and in some instances actual monopoly power on the part of the railways have disappeared.

- Q. Dr. Williams, now that you have done with the transportation part of my question, how would youlike to deal with the other part of it? The question was in the matter as a whole why if you are right, and there could be people who disagreed with you, that there is no pervasiveness of competition -they could disagree?
  - A. Yes.
- Q. In any event, how would you apply your doctrine to allowing the balance of the economy as a whole to go free?
- A. Well, as you certainly must be aware under our situation and, I suppose pretty much in other countries, at least of the English tradition the question of whether you have got a public utility or public service industry which the public concludes ought to be regulated is the question of whether or no governments have declared it to fall into that category. For instance, if one looks to the iron and steel industry, here is one that is comparable in some of its aspects; it is an industry of heavy capital investment. It too is an industry that unless the market is a pretty large market it will not sustain; perhaps you have competition. There is some element in that quite similar to the element that I have just talked about in railroads . We in the United



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States have not thought it desirable to regulate the iron and steel industry. Some people have suggested this ought to be, but, on the other hand, the industry seems to be pursuing a course of restraint inasmuch as not to have given rise to any great public clamour. I think you have a cast where many of these things tend to shade, they are not sharp distinctions. However, when you talk of motor carriers on one hand and railroads on the other hand you have two kinds of industries that are nearer to the poles than would be true if you were talking about the railroads versus the steel companies, and their respective economic characteristics.

Q. But to make your plan and to carry your doctrine of substitutional and allocation out, being a criterion of maximum regulation for the good of allocation of resources, to carry it to its complete and absolute end would require a completely planned economy, I suggest to you, not just restricted to transportation?

A. Well, I do not think that quite follows.

There are, I think, in our economy, and there must be
in areas rather large elements in which the competitive
forces can be said to be reasonable and likely producing
results that are not far different from those that
are a reasonable economic result.

- Q. You have mentioned steel. What about aluminum?
  - A. We are looking at things -- well, you



know we found some little trouble in that case in our own country. I do not know what the situation might be in your country but there are several ways of dealing with a problem of that kind. One way is to stimulate some competition where it is present which is what we did in the United States. In the alternative one could consider some manner of regulation to produce a like result, or at least some result.

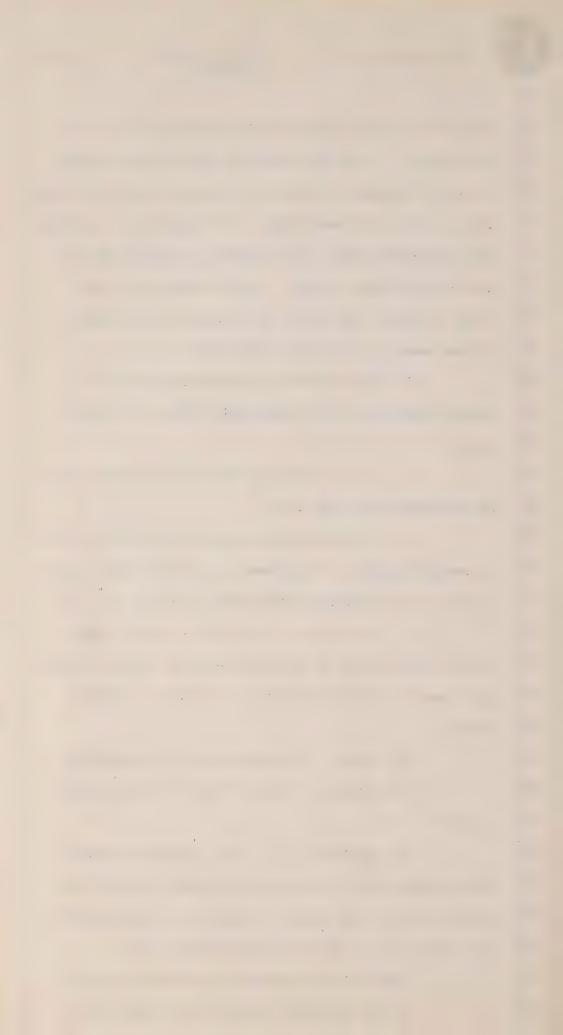
- Q. So the test of reasonableness of a maximum rate would be an extremely difficult test to apply?
- A. It is certainly true, and I think I said as much when I brought it in.
- Q. And you would also agree that your test of reasonableness of a maximum rate has not been adopted in any free enterprise economy that you know of?
- A. So far as I am aware it has not been adopted anywhere if by that you mean embracing it either into law or into administrative procedure. That is right.

MR. MAURO: Free enterprise or otherwise?

THE WITNESS: Yes, I know of no exceptions
to that.

MR. SINCLAIR: Q. Now, you have stated there appears to be a close relationship between the Canadian and United States transportation developments and further on in the same paragraph you say:

"Many of the geographic features evidenced in the northern United States extend into



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while even many of the political factors
which have a bearing upon transportation
policy have or have had counterparts in
the United States."

the more developed portions of Canada

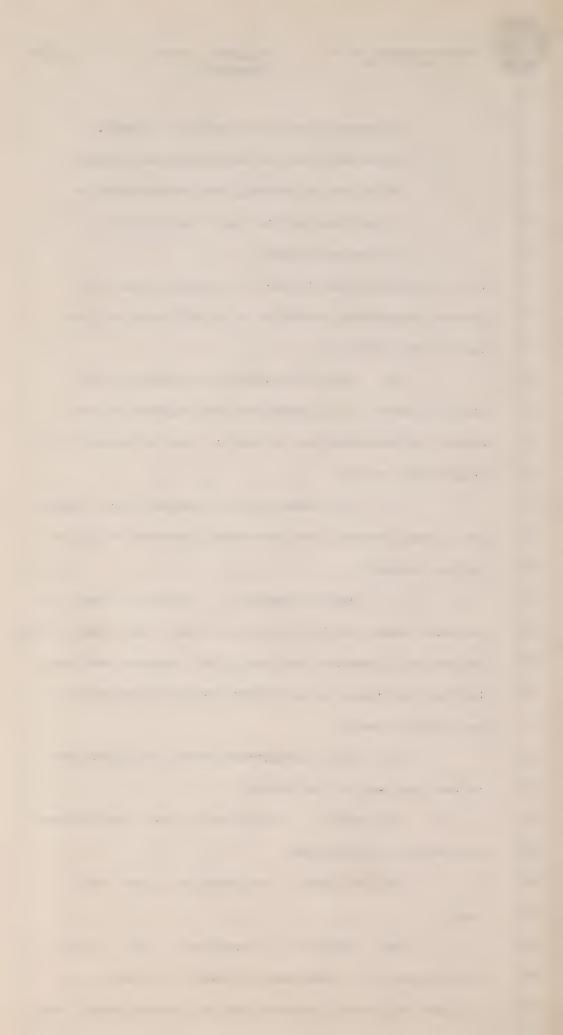
In the United States is there an appeal from the federal regulatory authority to a political tribunal such as the cabinet?

- A. There certainly is no appeal to the cabinet, there is an appeal to the Congress of the United States which has to take a form of search for legislative relief.
- Q. Yes, there is no recourse except through the normal process, the democratic process, of legis-lative change?
- A. That is correct. We put it that once you have exhausted the recourse of our court system under the existing statute then you go to Congress and seek legislative relief if you think you have not got what you ought to have.
- Q. As a transportationman, you agree that is the only way to run things?

MR. MAURO: I will have to warn the witness that he may be deported.

THE CHAIRMAN: Oh, that is a question of law.

MR. SINCLAIR: A question of law? Well, with respect, Mr. Chairman, if that is a question of law then the social sciences and all things maybe some



of us feel rather strongly about ---

MR. FRAWLEY: It is a question of baying at the moon.

MR. SINCLAIR: It is a question of the provinces having an unfair advantage which they have used and it is a question of the application in one particular case of things it is hard to believe happened in this country.

MR. FRAWLEY: God help us if you take it away. I am expecting this MR. SINCLAIR: Commission to recognize the existence of it.

Q. You have not got in the United States railroads with full power to own, operate and coordinate rail transportation with other modes of transportation?





### ANGUS. STONEHOUSE & CO. LTD. Williams, cr.ex. TORONTO. ONTARIO (Sinclair)

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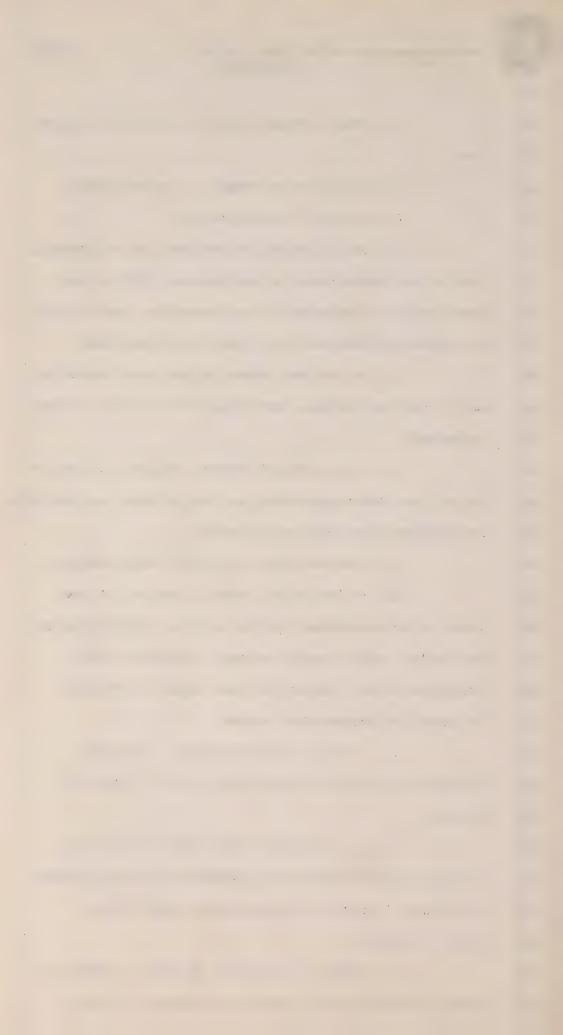
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law.

Q. They have in Canada -- you knew that?

They certainly have not under the present

- A. Oh yes, I understood so.
- Q. In the United States have you a situation that arises where there is approximately 90% of rail transportation conducted by two companies, one of which is privately owned and the other is nationalized?
- A. No, we have never had any such situation, and we have no national ownership of any of our railroad companies.
- Q. In the United States I suggest to you that collective labour agreements on the railways are much more restrictive than they are in Canada?
  - A. That has been my general understanding.
- Q. In the United States I suggest to you there is no counterpart to the Maritime Freight Rates Act or the bridge subsidy wherein the freight rate structure of the country has been used as a vehicle to subsidize geographical areas?
- A. I think that is correct. I do not believe we ever had a counterpart for that type of subsidy.
- Q. In the United States there are no rate levels fixed by statute and incapable of being changed to reflect increased transportation costs such as exist in Canada?
- A. That is also true. We have no statutory rates, although we have had a few threats of them.





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Happily, we do not have them.

- Q. I suggest to you that in the United
  States transportation subventions for the movement of
  traffic such as coal and feed grain is not a part of
  the transportation picture?
  - A. I did not quite get that.
- Q. Transportation subventions for the movement of coal and feed grain by railway are not part of the transportation picture?
- A. Certainly not, as a posture technique; we did have some in war time, but that was an exceptional circumstance.
- Q. In the United States security and competitive rail routes and routes involving numerous road transfers is a substantial problem in railway transportaton?
- A. We think of it as a rather serious problem.
- Q. In the United States there is conflicting jurisdiction between federal and state authority under the legislative and control regulation over rail carriers?
- A. I am not sure I would quite subscribe to that. There has been conflict over the years. Our general principle, of course, is that when we get into a situation where any action of a state regulatory authority might have an effect, or could be shown that is perhaps the proper way to put it could be shown to have cast a burden on interstate dommerce,



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then the federal authority is supreme. Now, if by "conflict" you mean a kind of running trouble, that is perfectly true. We do not have a case in the States where the Commission has granted that in whole or in part, but we have a whole host of section 13 proceedings?

- And also this question of what does or Q. does not create a burden on interstate commerce is a difficult question?
- A. It is a difficult question. Whale a good many of the difficulties were dealt with at least as precedents in a much earlier time, it gave us more more trouble earlier than now.
- Q. I suggest to you the average length of haul on class one railways in the United States is about half the average length of haul of the Canadian Pacific?
- A. I do not know whether that is so or not. I know what the average haul in the United States is, but what it may be in Canada I have not attempted to ascertain.
- Well, I will tell you that the average Q. length of haul on Canadian Pacific in 1958, was just under 500 miles.
- A. Well, our average haul taking the railroads as a system was then not too far behind. but if you are meaning to imply the average haul on a single railroad, we are certainly below.
  - Q. I have got a figure in 1958 that the





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average length of haul in the United States on class 1 railways was 251.3 miles?

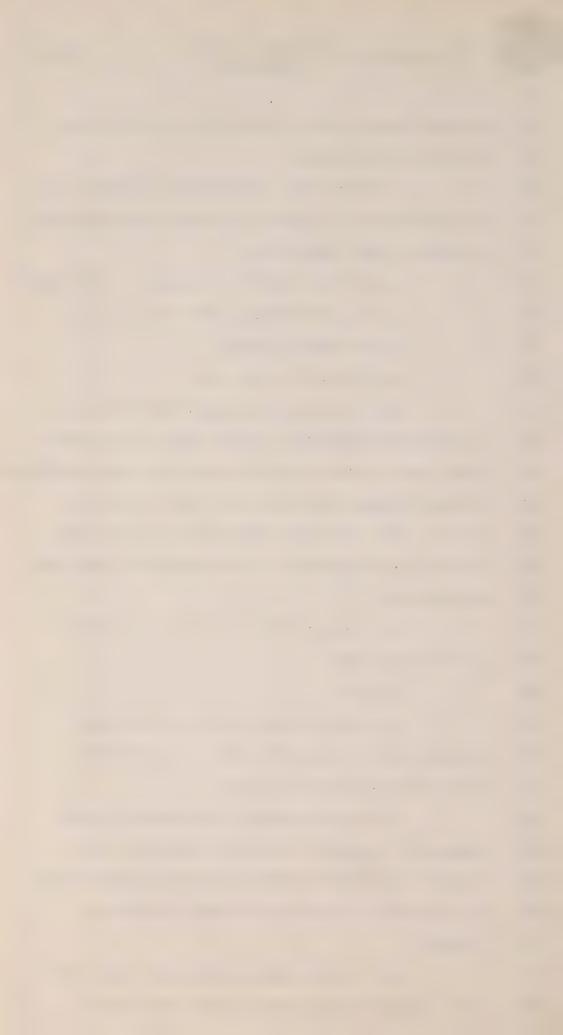
A. This is not considered as a system. If you consider it as a system the figure would have been somewhere in the order of 420.

- But this requires interplay -- interchange? Q.
- Yes, interchange, that is so.
- And that is costly? Q.
- It has its costs, yes. A.
- And you have mentioned that there is greater rate flexibility in Canada than in the United States, and we have discussed competitive rated traffic such as agreed charges and competition batch traffic by tariff. There are other flexibilities in Canada and they are not unimportant in rate making, are they, that you know of?
- You mean flexibilities by comparison with our practices?

Yes. 0.

Well, I think it well may be in that posture, but I would not be able to say in detail what flexibilities there may be.

- Q. For one example, you suggested it was necessary to recognize potential competition. By statute in the United States on transcontinental rates you are unable to recognize potential competition; correct?
- I do not think I would quite agree that it is outside the discretion of the Commission to





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recognize that.

Q. Does it not say in the section that it must be actual and not potential?

A. If you are talking about 4 section relief, that is right; it must be actual and compelling.

- Q. And not potential?
- A. That is right.
- Q. And it is restrictive?
- A. Certainly.
- Q. And another restriction you have got is that I suggest to you you can't put in rates except under special permission, except on statutory notice of 30 days, contrasted to Canada where you can put in rates to meet the competitive position on a spot basis without any notice and before the tariff is even filed with the regulatory authority?

A. That is true. We do grant special permission, but on a rather considerable showing of urgency, and it has to be dealt with as a special case.

- Q. And there is a time lag involved?
- A. Of course.
- Q. In view of these substantial difficulties in the political climate that we have spoken about, in the rate climate, would you not agree that what might be good or necessary in the United States jurisdiction could well not be necessary or good in this jurisdiction?
- A. Well, I am certainly willing to countenance the possibility that would be so. Obviously, one does not import something from one country to another merely



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principles to it.

Q. These marked differences require a close analysis in their differences and in the impact on the country and its manufacturing and its historical and economic complex before you can apply economic

because it is good in the one. It has to be examined

in the light of the country where you propose to apply

A. I would certainly think so, yes indeed.

To put it the other way around, we in the United States would certainly not accept without any examination precedents developed out of Canadian practice or experience. We would treat them, I think, as quite possible suggestions — things we needed to look into and see what nature and applicability they may have and what adjustment, if any, they might need under our own conditions.

- Q. Would you agree the necessity of dealing with costs to meet tests of being compensatory, such as are required in our legislation and which are not required in the same degree, if at all, in similar circumstances in the United States, has enabled the Canadian railways to be active in costing for a great many years?
  - A. This, so far as I know, is true.
- Q. Indeed, Dr. Williams, I think you will agree that costing on the Canadian Pacific and the people who have done its costing have been active in seminars in the United States in developing and advising on techniques?



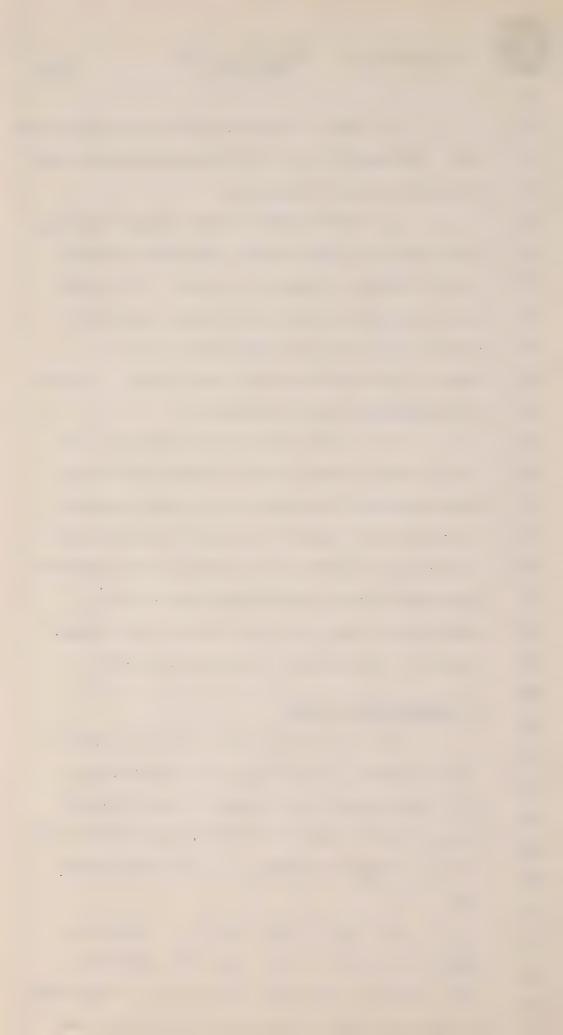
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- A. Quite. We have used techniques which they have leveloped for you in our submission before the Interstate Commerce Commission.
- Q. And the result of the Canadian railways being faced with their various advantages of having only two systems as against a myriad of systems such as you have in the United States, the drag of multiplicity leading to consolidation is not a problem and does not raise the cost such as has been happening in the United States?
- Q. I think this is very likely true. We think we have a large element of burden that falls upon us because of that multiplicity and because of our freedom with respect to multiple line routes and the degree of security it involves and the competitive duplication, which I would guess must be on a considerably larger scale than between your two main railways. That would be my guess at any rate.

#### BY COMMISSIONER ANSCOMB:

- Q. Dr. would you like to tell us what you think in Canada -- and you are not in America now -- of a situation where you have got a large national railway that has 26% of its total freight traffic tied up to a freight rate charge of over half a century ago?
- A. Well, I think that is a thing that ought to be looked at with a very keen and careful eye. My feeling has always been that it is undesirable to peg these things too sharply, and certainly that



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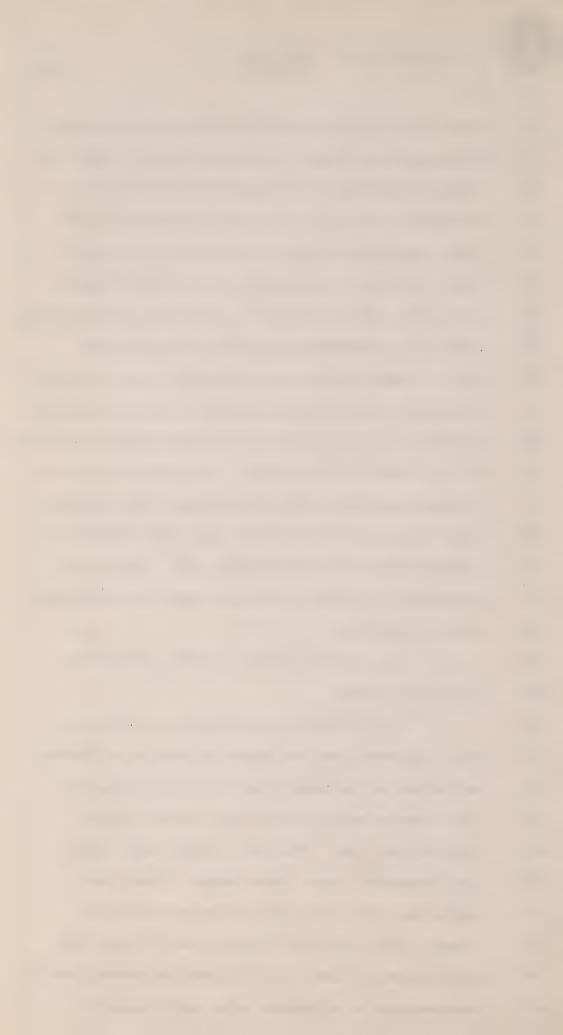
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there ought to be procedures for flexibility and for re-examination. What the situation would be here, of course, would depend on facts that are not within my knowledge; that is to say, I would think that these rates require to be tested since they have been in force for such a long period of time without change, and in the light of changes in technology of railroading, changes in composition of traffic, changes in the value of money and so on to see whether or not they are as of this time just and reasonable rates, because it certainly would not follow that because they may have been in 1897 that that is now true. But one could not say offhand merely from the fact they have been in effect for a long period of time that they are necessarily not satisfactory rates at the present time. There is a presumption, certainly, that they ought to be examined awfully carefully.

Q. You have nothing in that category in the United States?

A. We have no such thing as a statutory
rate, and never have had except in some of our states,
and in the period largely before federal regulation
came along in which we had things called maximum
rate and fair laws. They were not the same thing as
your statutory grain rates though. They fixed
maxima and very often these maxima were somewhat
liberal and on the whole they did not last over any
great length of time. So, they provided no very serious
embarrassment to adjustment with some reasonable



dispatch.

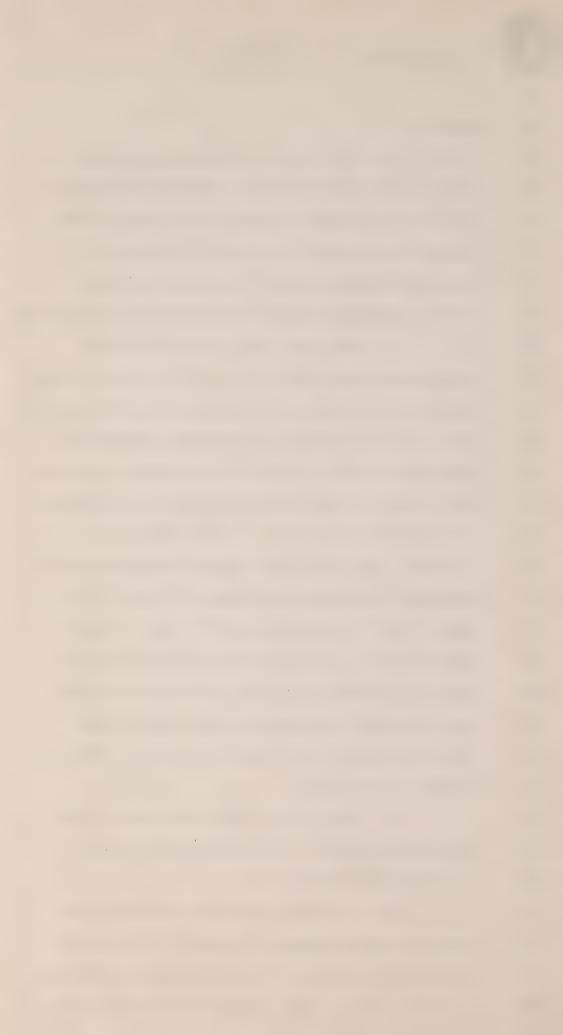
Q. I am correct in stating, I believe, by what you have said in the last couple of days, that there are no subsidies -- and I am not talking about original land grants or anything of that nature -- no subsidies given by any of your states or the national government to any railway in the United States?

A. Well, that would have been a true statement, I think, just a few months back but we have recently in the State of New Jersey made grants by that state for the maintenance of passenger commutation operations in what is a part of the New York regional area. Those, I think, ought properly to be described in the context in which you used the term as subsidies. The state of New Jersey have granted such subsidies to the principal commuter railways. But that, I think it would be correct to say, is a new departure for us. We have not in the past granted subsidies of that or any other character to railways since the great developmental period when we had assistance that was very similar in general character to what occurred here.

Q. Just on that point, could you tell us quite briefly on what basis the subsidy is given?

Is it volume of traffic?

A. I have not examined it in detail, but this is my understanding of it, which could possibly be not entirely correct. It was my understanding that it started out by a given amount of money being made



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1 2 available by the state which would have to be 3 distributed among the group of commuter railways 4 operating in northern New Jersey and generally into 5 New York city. Then, the question would arise how to 6 apportion it among them, and that was based on the volume of their commutation traffic -- essentially, the 7 8 number of commuter ticket buyers. It does not appear 9 -- I will not say it does not appear to be -- it is 10 not at a level which corresponds with the railways' estimates of their deficits in the commuter service. 11 12 but it goes some distance in that direction and the 13 railways have been required as a condition to accepting the subsidy to agree to maintain the level 14 of service which they have been operating. So, it is 15 16 not entirely a one-way street. It is a matter of agreement -- in effect a contrast between each railroad 17 and the state. Incidentally, it is a one year 18 19 proposition and I guess it is quite speculative whether it will be renewed. There is no permanence to it 20 21 beyond that.

> Q. Could you tell us very briefly what has happened in the last two years or, if it is necessary, go back three years -- but not way back -- what has happened in amalgamations with privately owned companies, which you all are in the United States, generally as far as railways are concerned, and what you think is going to happen in the next five years.

A. Well, we had in that period of time a merger between the Norfolk and Western and Virginia

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Railway Companies which are close parallel companies in the handling of bituminous coal out of the far west margin of Virginia and West Virginia to the Atlantic Seaboard. They are carriers which are very much alike in many respects. That merger went through ultimately without any final opposition standing in the way. It was worked out, I think, very ably by the Norfolk and Western management in meeting a wide range of local objection as well as the objection of their organized employees, and taking care of their objection before it appeared in a proceeding before the Interstate Commerce Commission, and the matter was handled quite expeditiously. The Commission only recently, and in the face of considerable opposition, approved a merger between the Erie and Lackawana railroads in the official territory where, because of the nature of the Lackawana as a bridge line in part between the Niagara gateway and New York City, working in conjunction with railways west of the Niagara gateway which do not have access to New York City, raised a lot of question about the maintenance of existing routes and existing joint rates, and the Commission attached its usual conditions designed to preserve the interests of other railways that may be affected by this merger. Apart from the position of other railways and the effort of certain of the labour unions to secure the attachment of conditions beyond which the Commission felt it was required under the law to attach, there was not a great deal of



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opposition to that. We have, either in the form of applications already before the Commission or probably about to go there, some cases that are likely to turn out to be vastly different. We have a proposed merger of the Atlantic coastline and the Seaboard Line Railway Company in the south which, among other things, would cast the Florida east coast adrift, and the Florida Peninsula with no independent connection to the north except for the Southern Railway Company which would create a new system and that is worrisome to the Southern Railway which is appearing in opposition, and it is complicated by the fact they have an interest in the railway which was merged with the Chatancoga and St. Louis. This will be a much more hard fought case than the ones approved in the past. When we get to the northwestern matter, there has been work for some years now on the question of merging the Great-West , Northern Pacific, Burlington and Spokane, Portland and Seattle; they are closely tied together by the stockholdings of the Northern Pacific in the Burlington and Spokane, and the joint ownership by those two of the Portland and Seattle. That too will be a very controversial case. None of us have any idea how the Commission will deal with such controversial measures. Our law, after all, is one which really does not set forth very much in the way of standards and under which the Commission has to deal with matters of this kind. We are now finding railways are coming forward with consolidation



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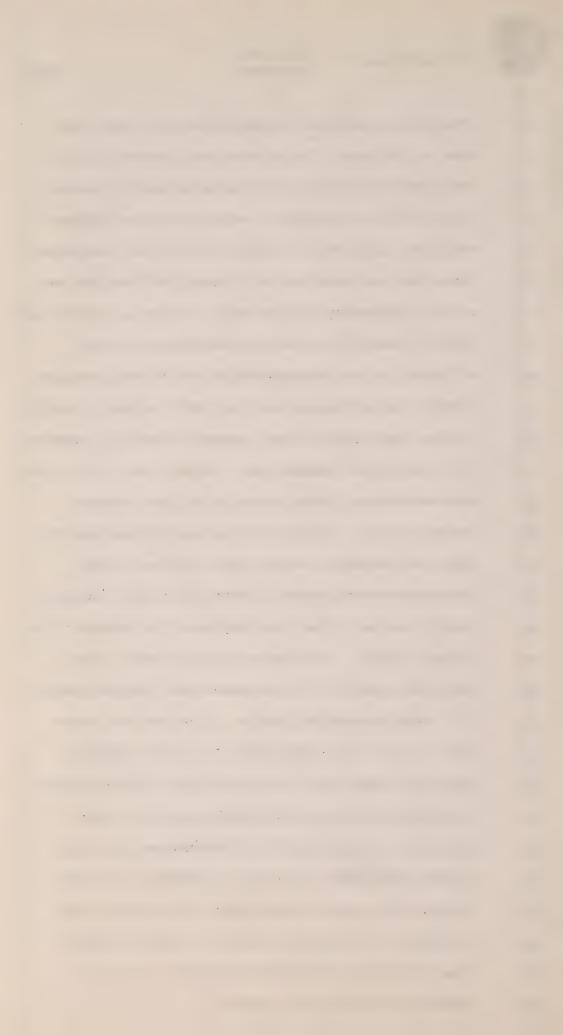
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proposals on different grounds than were often the case in the past. The argument now is very much in the direction of improving the efficiency of railway system and the emphasis is very much on the savings which are expected to be realized, and the Commission faces the hard question not dissimiliar from the one we were discussing a while ago, although in a different context, whether the savings that promise more efficient railway transportation out of these mergers outweigh these dislocations that will certainly result to other railways and the present channels of movement to certain local communities. In the case of the Erie Lackawana merger, they expect to put the through freight traffic over the Erie Railway Company and to place the passenger service over the line of the Lackawana through Scranton where it is now a largely three track main line, but they expect to reduce it to a single track. Scranton has for long years been deeply dependent on the Lackawana, and you can imagine it is very disturbing locally. I do not know where that will go, but I think that is a fair summary of pretty much where we stand apart from this interesting competition between the New York Central and the Chesapeak and Ohio over the Baltimore and Ohio which at the moment seems to be at a standstill, in which the New York Central is desirous, if it is not able to control the Baltimore and Ohio alone, certainly of a threeway merger, and the Chesapeak and Ohio opposed to the three way merger.

--- A short recess



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THE CHAIRMAN: Order, please. Mr. Mann?

#### BY COMMISSIONER MANN:

Dr. Williams, you have had a pretty extensive discussion with counsel. There are a few questions I have; some of them have been covered, and some of them I would like to get a little information on, if I may.

Before I start these questions, there was something that arose out of Commissioner Anscomb's question to you with regard to subsidies in the United States. You mentioned that the State of New Jersey had recently given a commutation subsidy. Am I right in recollecting that there are discussions going on in the State of New York and Pennsylvania for similar subsidies?

There were discussions in the State of New York. I do not know whether there are any currently in being. Right after Governor Rockefeller took office, there was set up a small group to look into the problem of the New York State commutation situation which broadened its terms of reference; either it did, or perhaps its instructions entitled it to do so, to consider the state of railways as a whole in the It did not result in what I would State of New York. call a subsidy. It resulted, however, in a reaffirmation of the tax loss as applicable to railroads in the State of New York, which brought the level of taxes over a five-year period in successive steps down to



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a position that is not in great disparity, at least, from what happened in meighbouring states, such as Pennsylvania and Ohio, because it was disclosed that the level of taxation in New York State was well above the pattern of most of the states, and by no means as bad as New Jersey.

There was, of course, the making of funds available to the port of New York authorities for the purchase of cars which would be made available to the railroads on a rental basis, and undoubtedly there would be no subsidy there. It is a use of public credit, however, which raises some little question as to whether it was a minor subsidy element.

- Q. You partly anticipated my next question, Dr. Williams, which was the use of the tax structure as a means of relieving railroad disabilities, and you mentioned that this was being done in the state of New York. Is it also done on the municipal level at all?
- A. Well, yes, it is in some situations, and notably in the state of New York in the case of the Long Island Railroad Company which operates under a special statute of the state as a railroad redevelopment corporation and which, after it had gone into receivership and long proceedings had ensued to find ways and means of making it viable, it resulted in an agreement that resulted in a reduction by one half of local taxation in counties and communities in Long Island. It is always a method that is being



suggested. It is being suggested actively by the

New Haven Railroad. Within the states it serves, for
example, as a means of relief for the situation of that
road.

There may be other examples of it with which I am not familiar.

Q. Thank you, Dr. Williams. Now, if I may turn to the questions I had, on page 3 of your submission you have the statement:

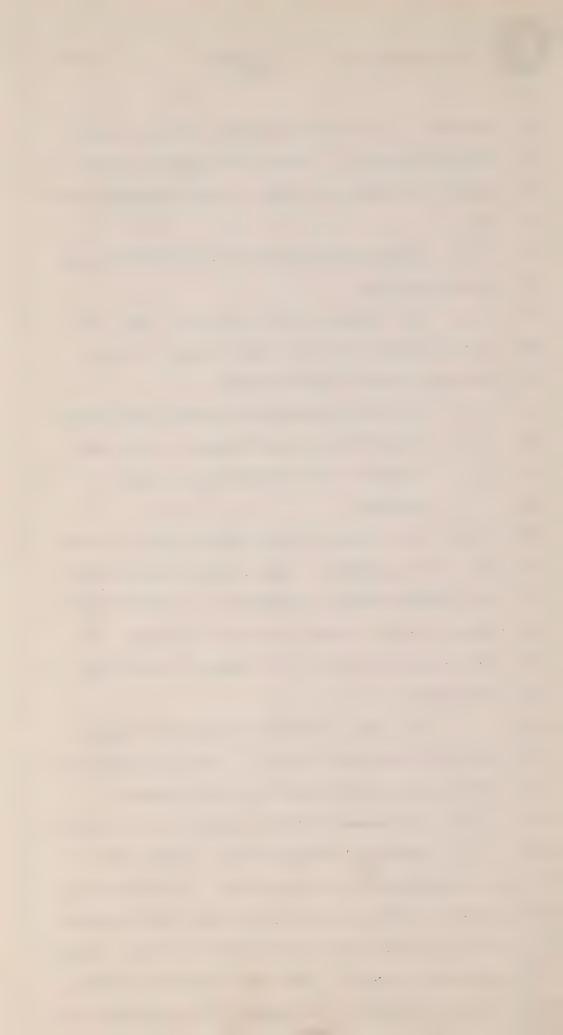
"For in an economy which seeks rapid growth,
expenditures for performance of the transportation function ought to be held to a
minimum."

I wonder, Dr. Williams, whether there could be a case made for the opposite? What I have in mind is the use of transportation expenditures as a pump-priming function for the economic growth of a country. I refer you particularly to the Canadian West and its development?

A. Yes, I think you can make and argue a case on the other side of this. This is my conclusion, and there are certainly some who would disagree

and would disagree rather violently with me on that.

However, I think one has to examine what the conjunction of circumstances is. We, after all, followed a policy not greatly different from the policy that you followed at an earlier time in opening out your own western country. There is a question on which no doubt economists would disagree, as to whether once



opened out but is moving to a more intensive stage

of development, that same kind of medicine is appropriate;

it may fit well one set of circumstances and not fit

well another.

Q. Generally, then, in the less developed

you have a basic transportation structure and what you

- Q. Generally, then, in the less developed strata of the country; for instance, for the opening up of the Canadian North there is a case, perhaps, to be made that does not look primarily to the minimizing of transportation expenditures?
- A. Oh, well, of course, where you are dealing with territories still to be opened up, it without question is necessary to provide transportation facilities yet.

There was in our own development, of course, a certain recklessness, thoughtlessness and generality about the way in which we expanded our railroad system by government aids into the west, and there was a sort of a kind of a feeling that if you could only get transportation everything would follow in train.

This is not true, unless other circumstances support it. As one moves into opening out new areas today, I would hope in such a case as forest or mineral resources, which are to be brought out, one could pinpoint the transportation requirements closely enough so one does not need a lavish development, but one essential to the purpose in view.

Q. In the discussion we have just had, it



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was clear to me I was using transportation as transportation rather than railways, and I take it your reference was the same?

- A. Yes, quite, and thereis the further question if you want to open up some territory, given those circumstances, is it wise to do it by railways or some other form -- which is an election we did not have at an earlier time.
- Q. Dr. Williams, on page 5 of your submission, and we have already had some discussion of that with Mr. Sinclair, you give an estimate made by students of transportation in the United States of the mileage which is in excess.

Now, what I wondered about, and this I do not think has been covered, is what criteria one, could use in seeing whether rail mileage is in excess of requirements?

A. No very simple criteria, I am afraid.

An excessive mileage, as we use the term generally means to us that because of the nature of our competitive development we want to work and put competitive lines on railroads to a great many points and into closely adjacent territory; and, in consequence, we laid down far more railroad plant than is really required to perform the volume of traffic between the points in question. We are in the position, therefore, in many instances where if we could concentrate the traffic on one or a few of a number of lines we would certainly have a more efficient performance of



a further dividend in that we would be capable of concentrating such capital generalization as we have in the railroad industry on a more limited mileage line and could produce far better standards in traffic densities and get, overall, a much better result.

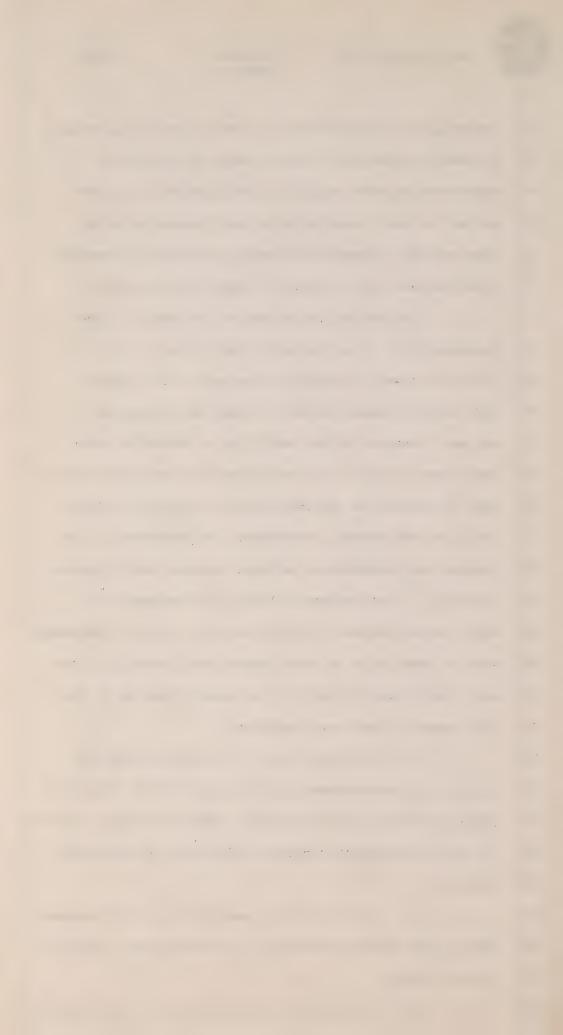
One has to judge that on the basis of the dispensability of a line which may be due -- Mr. Sinclair spoke of looking at the map, and I agreed with him you cannot decide anything by looking at the map, because you may well find a situation which means that you have such an amount of connected industry that is reliant on the railroad on a particular line, and given the terrain conditions and otherwise, as to prevent that abandonment without causing some structural disorder. But we have a lot of circumstances in which we have almost directly parallel lines of railways, some of them built at quite heavy cost, unhappily, and where the volume of traffic has never grown up to the full capacity that was installed.

What you come down to is that in order to

come to any such estimate as this you have to study the

thing in detail and consider the alternative ways in which
you would accomplish transportation over the remaining
network.

- Q. And the extent and quality of the highway network and waterway network, of course, have a bearing on that study?
  - A. It may have a bearing on it; very frequently



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where we have a line of railroad that is handling any volume of traffic of consequence, it is rather rarely the case that you can ascertain that it would be cheaper to supply highway transportation instead, even if you have the highway already there. The railroad may, with the volume of traffic it has, not be operating at any kind of optimum for the installed capacity, but it may still be providing transportation more cheaply than we could generate it on the highway. Exactly where that dividing line is would depend on the conditions of the particular railroad, on the one hand, and what could be done with highway transportation in that location, on the other.

- Q. Is it possible to make excess capacity estimates for given segments of line?
- A. Oh, it is possible to make estimates for almost anything.
  - Q. I mean, valid estimates?
- A. But that one is a very difficult problem. You can, and the manual of our corps of engineers of the army has a formula for that. I suppose maybe the Canadian army has something similar. You can calculate a theoretical capacity of a line of railroad which assumes that you load it twenty-four hours a day at what is indicated as the theoretical capacity. This is almost without meaning. It may have meaning in a military operation, because you can then adjust your traffic into that capacity. But we have the problem



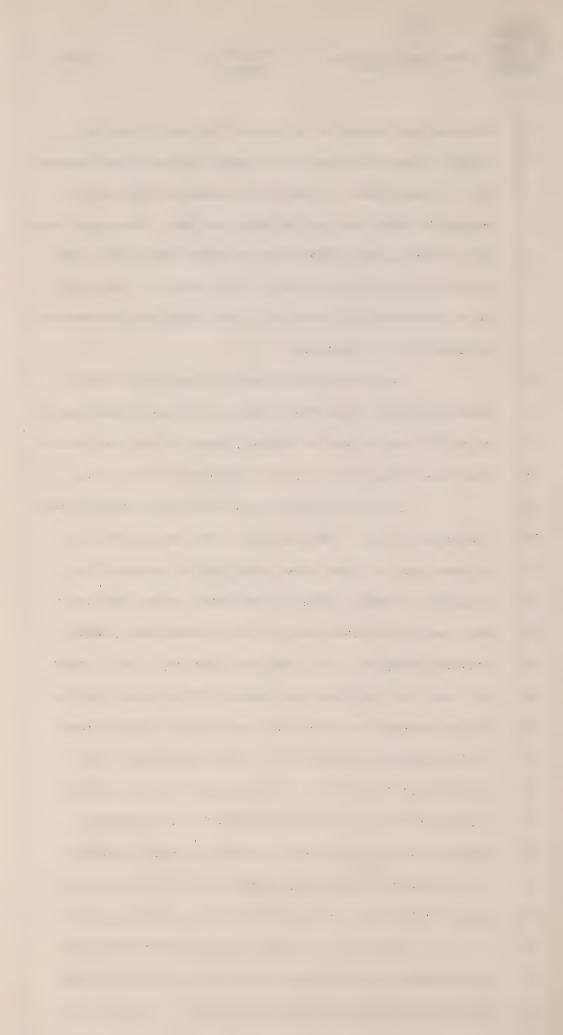
that we are dealing with commercial conditions in a highly competitive world, in which any railroad company quite clearly has to operate its services with some regard to what the public needs and what its competitors are offering, in consequence of which the useful commercial capacity of a line of railroad will turn out to be something substantially less than any theoretical estimate of its capacity.

Our Interstate Commerce Commission toyed,
some years ago, with the notion of trying to make such
capacity studies and ultimately came to the conclusion
that that thing could not be pinpointed very well.

Railroad officers may often have pretty good judgments of it. When we went into the Second War, a great many of them were surprised to discover the capacity of their lines of railroad, which they would have hardly believed out of their experience prewar.

Another example is you come back and say, "Well, that is 1944; the railroad was loaded with so much trarric, and we managed to handle it, and we are pretty close to the maximum, so that is a representation of the capacity of the line." But, unfortunately, a railroad plant does not stay constant in its physical characteristics, nor does the trarric stay constant in its pattern and other requirements so that you can carry that kind of thing forward for very many years.

Q. You are, of course, familiar with the fact that density studies have been made in terms of gross ton miles per mile of track per year. Do they, in



your opinion, give you a pretty good indication of capacity or excess capacity?

A. Not standing by themselves. I would say, for example, you might have a density over a line of railroad and denominate that line of railroad as a single track. But there are all kinds of single tracks. You may have a railroad of difficult or easy profile; you may have a railroad with frequent or infrequent passing sidings; there may be long or short passing sidings; there may be a tracks signal system or centralized traffic control, or nothing but the use of time table and train orders. All these things affect the capacity of the line.

If we go to double track railroad, many of those same things may have an effect upon it. So I think you would have to take density over against the particular facility on which that density was being accomplished, and then you could probably perform -- you could achieve an educated guess as to how well that railroad was loaded.

- Q. Turning to another subject, Dr.Williams, and you have had some discussion about this with Mr.

  Cumming, on page 7 you seem -- at least to me, and I may be wrong -- you seem to make a distinction between commercial and market competition, and that distinction was not clear to me, and I wondered whether I have read a disctinction into it that I should not have?
- A. I thought at one time we tended to make a distinction, but that distinction has tended to be



blurred. I often use the term "market competition" without anything else, as referring to those kinds of competition that are other than direct carrier competition, which arise out of any of the commercial relationships, whether the source for new inbound competitive supplies or the seeking for excess to market outside. So that, I did not really intend to imply a distinction here.

Q. In your brief, Dr. Williams, you point out a central problem of finding ways to use each of the modes of transportation severally and in combination in such a way as will conduce to the greatest efficiency in the discharge of the overall transportation function.

Now, I think you have already had some discussions about the question of ownership of one mode of transportation by another, and if my recollection is right you said that there should be no restriction on the ownership of one mode of transportation by another.

I wondered about what you said, or what you and your colleagues said, in the Federal Transportation Policy and Programme, where I find at page 8 the following passage:

"Generally, control of one mode of transport by another is neither necessary nor recommended, although a more flexible attitude on the part of the regulatory authority is desirable where a clear demonstration can be made that increased efficiency will result."



A. Yes.

Q. When you gave your answer earlier, it was in the light of this; was it?

A. Oh, in the light of that, but I was speaking with respect to my personal views earlier, and quite without regard to what might be appropriate to place in a government report within our own particular context at this time.

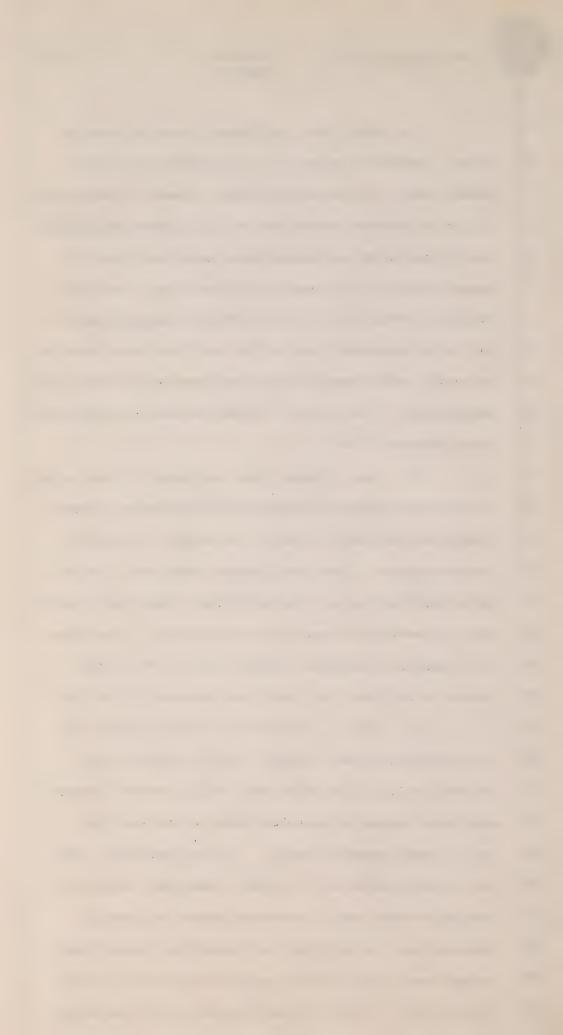
which what was recommended certainly does not go as far as I would recommend in the ultimate, but which, nevertheless, go in the direction that I would hope that we might be moving in, and we do, as I suppose most governmental groups do, have some hope that our recommendations or at least some of them would appear not so unreasonable in the context of our conflicting interests so that it would be possible to at least carry some of them into force.



We start from a different position because
we have restraint in the Civil Aeronautics Act, the
Panama Canal Act and the Interstate Commerce Commission
Act, and elsewhere, which keep us in a pretty watertight
separation, with some exceptions, among our forms of
transportation. We would look for a way possibly of
getting a mitigation of that without bringing down on
our heads the whole force of the conflict about what the
railroads call diversification and what some others call
integration. We did not succeed because nobody mistook
the direction of it.

Q. Mr. Sinclair gave you what I think is one of the most complete catalogues of differences between Canada and the United States with regard to railway transportation. He also discussed with you, I think under that heading of national policy lines the concept that you mention at page 34 of your brief. Are there any examples of national policy lines in the United States or any that fall into that category in any way?

A. Well, I suppose you could go back and conceivably take the original Pacific Railroad as a national policy line which was a thing carried forward with more expensive subsidies than we had ever had in our transportation setup. It was done with a few not to its prospects of minimum commercial return but because we were deeply concerned about the Pacific seaboard and its political and commercial relationship to the rest of the country and the risk that it might be torn off. I think youmay say that was a national



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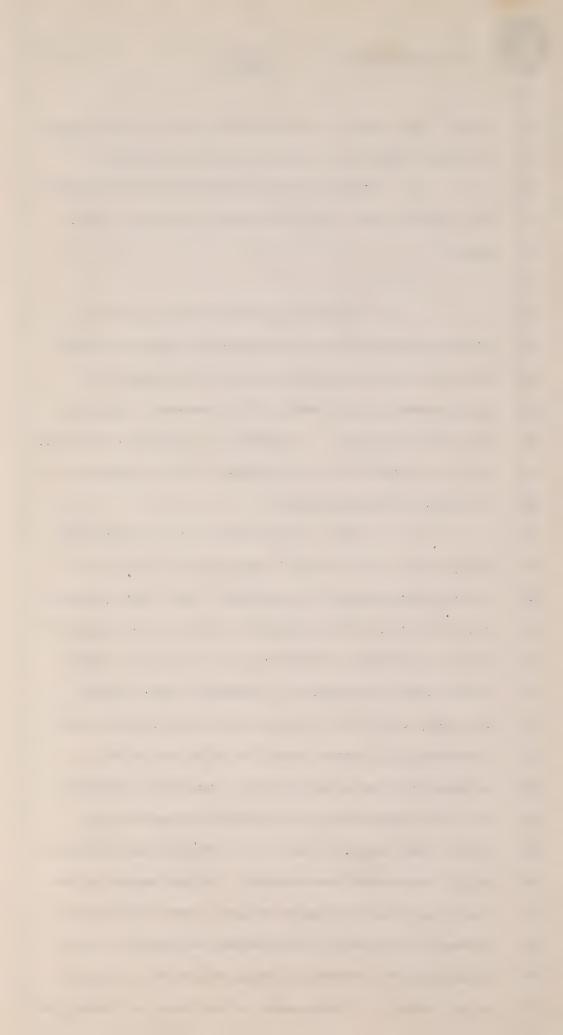
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of others that fall readily into that category.

The travails of the minute men will not Q. make policy lines out of your whole railroads, will they?

policy line, that is, at that time, but I cannot think

- Α. No.
- At page 35 you are dealing with subsidies in regard to the abandonment problem and that brings me to the general problem of subsidies in transportation about which this Commission has heard quite a bit so far. I wonder if it would be possible for you to spell out the criteria for the granting of subsidies in transportation?
- Well, I think that is a very difficult So far as I have tried to do it, it thing to do. looks to me somewhat in this guise that where you have a situation in which government policy in some shape or form requires carriers to do or not to do certain things that the underlying economies would suggest that they ought to do or not to do and where that is a reasonably clearcut situation which could fall perhaps from the conclusion of a sustaining project into, notwithstanding substantial showing that the line of the railroad could not sustain itself economically, abandonment was denied. It may happen in the case of a situation where we have a non-compensatory element in the rate structure and yet public policy intervened to prevent its being raised to a compensatory level. These would be the kinds of things in



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which I would think subsidy might be an alternative that ought to be considered.

Subsidy, of course, is a thing worrisome to anybody in economics and I suppose more worrisome to those of us who come from the States perhaps than those of us who come from some other parts of the world. It would be, I think, a desirable further criterion that if such subsidies were to be established we saw some hope of perhaps some process associated with them which we could rely upon with some confidence of enabling us to get rid of them. Again there may be reasons lying outside the transportation areas. There may be cases where one would feel compelled to do something more than that.

- Q. If the criteria that you have set out
  were to be met is there any fear on your part that
  subsidies so given might interfere with the transportation pricing system?
- A. Well, in the second case where I suggested there might be a case for subsidy as a result of an unwillingness to permit non-compensatory rates to be raised. There is also the point of tampering with that economic principle so far as subsidy is concerned and the subsidy is a directive rather than itself a cause of dislocation in the rate structure in the case of sustaining services which are maintained at a loss, but, fortunately, not permitted to be sustaining for reasons of policy presumably outside the realm of economics per se. I would think that subsidy on the



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whole would be constructive in helping to maintain a good and equitable rate structure in the rest of the picture rather than a disturbing influence per se.

I would not like to see subsidies the effect of which was to impose some kind of structural disorder on a rate structure having all the economic principles otherwise.

- Q. That does raise the other point though, Dr. Williams, of the role of the state in granting relief or giving assistance to one agency of transportation but it does not do so to the same extent to another. Now, you dealt very extensively with that both in the rationale of federal transportation policy and the federal transportation policy and programme?
  - A. Yes.
- Q. Now, what I wondered about was how you preserve the neutrality of the group when you give subsidies unilaterally to one agency of transportation?
- at all. We have done it, of course, we have various forms of transportation or at least it could be argued that we have in the States quite a persuasive case made. I think you would fall onto some dangerous ground and perhaps this suggests that there would have to be another criterion that did not occur to me a minute ago because if you were to take a situation where you have active and effective competition between rail and truck over a good rate and for some reason or other—— I do not know what the reason may be, I cannot



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imagine what it would be -- suppose for some reason or other there was imposed a hold-down of certain elements of the railroad rate structure within the competitive area and then a subsidy granted. Normally the result of that would be to set in motion conditions that give cause to misuse in the economic sense of the two forms of transportation. I do not know what your practice might be in Canada in respect of the way you support your highway system and your other public facilities, if you conduct all transportation by nonrailroad methods. Our problem, of course, has been that we have had substantial government investment in these ares which in so far as the commercial use of these facilities are concerned can be construed as subsidy to non-rail forms of transportation and we have no counterpart in the rail case.

- Q. Was it with that in mind that yourgroup suggested that federal investment in the United States on transportation ordinarily should be properly planned?
- another reason which we thought to be rather forceful.

  We have a fear and I think considerable evidence to support it that we have indulged in an awful lot of wasteful expenditure in waterways improvement and highway improvement as well as in port development and other things of this kind. We thought that we needed a situation not only which came nearer to neutrality as between those types of transportation which is public facilities and the railroad and pipe line



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facilities which provided their own facilities but that were also needed rather urgently out of a budgetary concern and what we feared there was substantial wasteful expenditure in those areas.

- Q. In order to ascertain that it was your recommendation that adequate cost-finding techniques be developed for a form of transportation including exempt transportation?
- A. Well, I do not suppose we spelled that out, but it would be rather necessary if the thing were to work completely that we have some data with respect to exempt and with respect to private transportation also, especially in the case of both of these forms of transportation, because we have reason to suspect that the operators thereof not infrequently deceive themselves and, if so, may be operating on false premises.
- Q. You would require, then, I suppose, the regulatory agency to equip itself to the fullest extent with the means of doing adequate costing.

  Would that be a necessary consequence?
- A. Well, it might come down to that. We, I think, may have expressed the hope that much of the basic work of development, more adequate tools for cost analysis could be done by the carriers and expressed the view that indeed with the regulatory system and perhaps the trending result it was an obligation of the carriers. However, I think we had little hope through that process we could develop fruitful comparative cost analyses by the



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A. Well, I would say that in the first

various forms and we would have to have an approach at the governmental level.

Q. I was taking my cue from page 20 of the federal transportation policy where you say:

"Temporarily retain a costing base on Form A, provide the ICC with staff and funds to study possible improvements."

A. That is what we finally came out with.

We had some other suggestions at various stages in the game.

Q. This, of course, lays the groundwork for my next question which refers to page 37 of your brief where you say under subheading (a):

"Where traffic can be retained against competition only at below cost levels, such traffic ought to be shed."

On the next page you say:

That is the recommendation.

"But rates established close to the level of cost may be allowed, in the absence of continuing review, to fall below a changing cost structure or to fall below the level which changing competitive circumstances require."

Now, inherent in both these passages I have quoted is some sort of review or supervision, and my question is, who is to ensure that such a review will take place and will take place properly?



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instance it is clearly the responsibility of the carrier to do this type of thing and certainly it is in the interests of the carrier to assist in maintaining rates that are remunerative. It is, of course, a very substantial task to keep a rate structure as complicated as this and with which we are familiar under continuing review and examination. It is unhappily true, I think, of most of our railroads, so we run into the situation with the passage of time and precisely this happens. The public authority, I think, so long as we maintain the regulatory system in respect of transportation is entitled to assurances that this process is being performed and being performed reasonably well. Nobody would say it could be performed to perfection because it is too complicated a thing for that. Now, how that at least can be got is, of

course, a question. In our own feeling about it we have looked upon the thing as almost insisting that it be done at the governmental level so long as we attempt to maintain a situation in which we are sure that rates are compensatory. We are almost compelled to do it publicly because we have such a large number and variety of carriers of all developing size, commodity scales, commodity attitudes and skills, and so on, I do not see how we could avoid it. Now, whether you need it in Canada I would not be certain, but I would think that in all likelihoof the Board of Transport Commissioners would be obliged to ensure itself that



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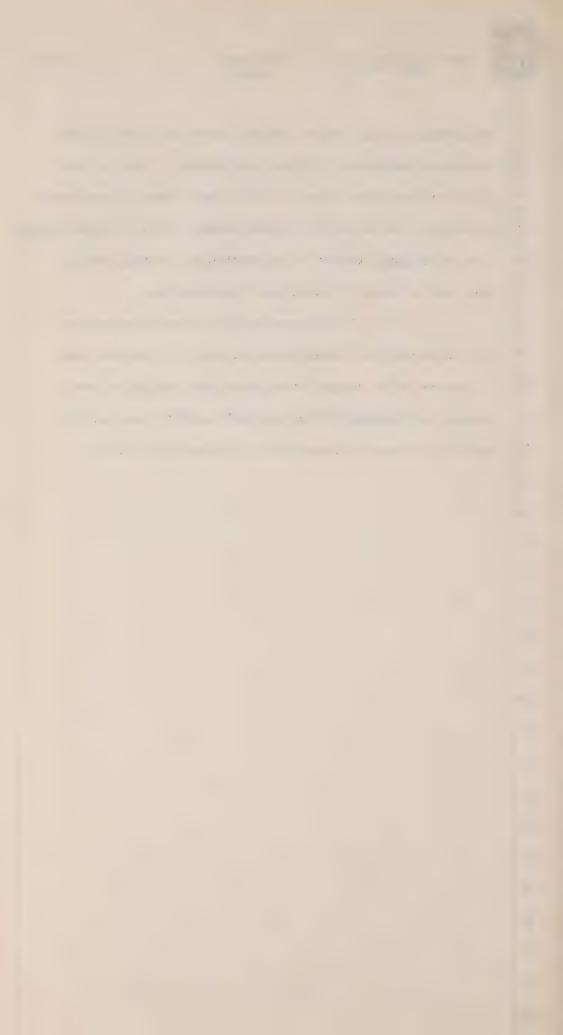
29 30 satisfactory procedures were in force to accomplish this object. Otherwise, it would not have the assurance that the situation that Mr. Sinclair was pointing out as relates to your law, as it applies to new rates, is being carried out in the rate structure as well and continued over a time.

- Q. Do you think cost information so obtained by the regulatory agency should be made public?
- I am all in favour of it myself, I think it is a very useful kind of thing and it has proved in our case to be helpful to shippers and railways alike. It has greatly expedited the process of negotiating rates in numerous situations and it has reduced to manageable proportions at the level of negotiation some things that I am sure would have become controversial matters before the regulatory body. not like to see things getting into the regulatory process if there are ways of settling them short of It has enabled this whole problem of the relationships of competitive carriers to be looked at in some degree and its implications to a greater degree understood than would have been possible without it. We have also territorial groups of motor carriers continuing studies not on the same basis as the railroad, but they have certainly been useful so far as the Commission is concerned under our suspension situation. I do not think you have the equivalent of that under Canadian law but we have had a wide variety of uses Although the publication was resisted by the for it.



railroads at the start I think there has been an increasing awareness of their usefulness. Now we are over on the other horn of the dilemma that I mentioned yesterday, that we are afraid perhaps we are contributing too much significance to a particular formula which may not be ideal to meet our requirements.

Q. If you have reliable cost statistics for each mode of transportation and you publish them, is there not a danger that you might prejudice one agency of transportation against another because you might give away information of commercial value?



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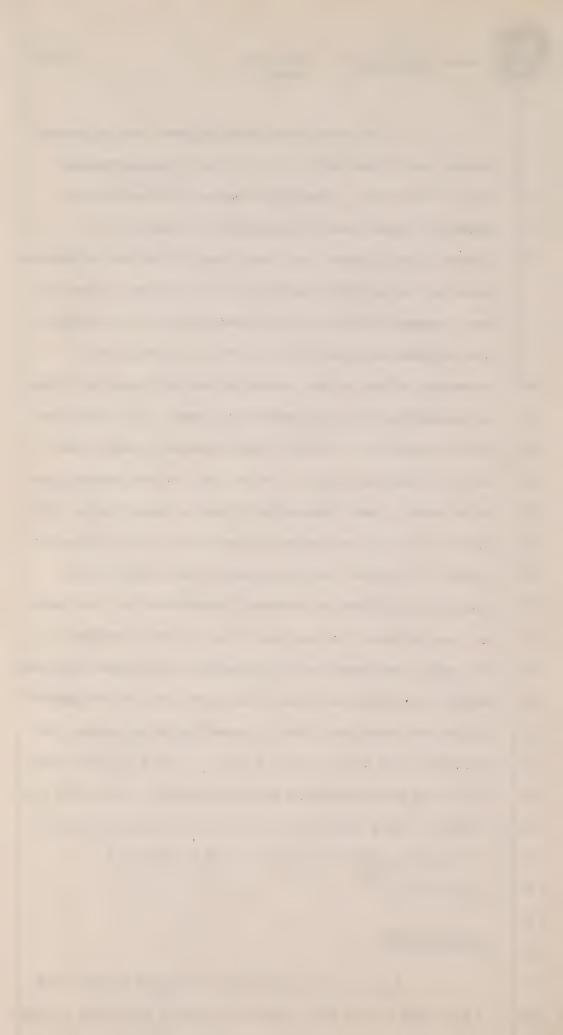
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BY MR. PLATT:

Q. You have certainly been most helpful and I hesitate to ask this question because I am sure it has

A. We have heard that argument in the United States and I have had a little trouble understanding what it comes to. Observing the way our regulatory system is threatened in any event when we get competitive disputes, and more than 90% of our suspension cases are competitive disputes, it is becoming more and more imperative that if the Commission is to discharge its obligations under the law that it attempt to ascertain which is the carrier relatively most efficient in connection with the traffic in issue. It cannot do that without cost evidence that relates to both sides, or more than two sides if there are, in the competitive relationship; and increasingly that is being done. So, if you do not have continuing published cost scales, at least in our case you always have cost figures that could be described as somewhat representative in a more or less relevant period, and I do not think anybody is too much concerned about disclosing cost figures any more within the regulated area. When you come to the matter of private carriers, that is something else again. We have the same trouble that you do -- which I gather you do -- and they sertainly are not enxious to disclose the level of their costs, and to get any of them to testify on the stand as to what that is is a difficult proposition.



would this matter so much? It would be the weaker ones
who would be wiped out?

A. I think, if I may answer that in a slightly
different vein, that the overall effect on the economy

been covered, but I did not quite get it through my head, and that is the control of maximum rates. As you are well aware now, conditions on Canadian railways are much different than in the United States. You understand how our maximum rates are regulated, in a rough sort of way?

A. I think so.

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Q. And you end up with a permissive level and having essentially three groups. Supposing you had no maximum rate regulation at all, and those people could take the full amount -- would continue to take the full amount or more than that, and eventually you would reach a point where it would be a matter of negotiation. Now, if I am a captive shipper with no alternative means of transportation, and have a large output of goods, the railways are not going bankrupt providing they can haul that stuff and still make money. So, it becomes a matter of negotiation?

A. Yes.

Q. If I did not have much stuff to ship, they would perhaps not be so much concerned, and I may go bankrupt. But, in the overall effect on the economy, would this matter so much? It would be the weaker ones who would be wiped out?

A. I think, if I may answer that in a slightly different vein, that the overall effect on the economy that would worry me is not so much the fact that some existing shippers -- possibly, as you say those having limited negotiating power -- might disappear from the scene. What seems to me far more disturbing is that if



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this kind of result is present as respects areas having economic resources of considerable usefulness to the economy, this kind of thing stands as a bar to the development of those resources.

Q. But if you discover a mine or you have got timber, you will negotiate a rate with the railways so that you can exploit that. If you are going to manufacture something you will certainly not go ahead and move into an area where you are subject to continuing freight increases — unless you were a real exponent of regional development. So, would it make any difference?

A. Yes, it would make a difference, I think, if you propositioned that the remain a difference in the basic resource situation. What happens here, in effect, is that if you look into the question of the total cost of producing something on see leads of resources, and maybe the necessary resources are available in an area which has the benefit of apprention and is operating with a competitive level of rates hold for handling the inbound material which will be processed candling the outbound goods to the market. There may be another area that falls in this so far non-competitive area which has been taking the increases and the exact they will have to take some more if the same set of rectors goes on as has caused the increases in the past. Here you might easily have a better quality of resource, possibly better located in certain respects to accessibility as a resource. You may have other elements in the cost structure of transport or and training it that would be





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29 30 lower than down in the competitive area. The thing that might offset that would be this deterrent of the higher rates or that these rates would take increases. So, you go down here and use the economic resource that in all other respects, except the transportation, cannot be accomplished as cheaply as it could over here. I am making a simplified example to try to illustrate it, but in a great many lines of industry and resource exploitation the freight rates are not without significance, and I think it would certainly be likely that in areas that may be affected by the kind of process you were mentioning, there would be a deterrent to the use of resources that could conceivably be superior to some somewhere else. I cannot say whether that is important in Canada or not, because it depends on a pretty complete analysis of the resource base and what areas we are talking about. But, at least in theory it should certainly, to an economist's mind, do some damage to the efficiency of your economic development to have this kind of a continuing condition.

COMMISSIONER PLATT: Thank you, Dr. Williams. I think I will still go and locate my plant where there is competition.

THE WITNESS: Well, it is very much the practice of many of our industries, as we have found, to do just that.

--- Adjournment ---













